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IN THE

Supreme Court of the United States

October Term, 1973.

No. 73-914

GEORGE P. BAKER, RICHARD C. BOND, AND JERVIS LANGDON, JR., TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR,

Petitioners,

v.

INDIANA HARBOR BELT RAILROAD COMPANY, MEMBERS OF THE COMMITTEE OF INTERLINE RAILROADS: THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY, ET AL., AND LOUISVILLE AND NASHVILLE RAILROAD COMPANY,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

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IN THE

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No. .

GEORGE P. BAKER, RICHARD C. BOND, AND JERVIS LANGDON, JR., TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR,

Petitioners,

v.

INDIANA HARBOR BELT RAILROAD COMPANY, MEMBERS OF THE COMMITTEE OF INTERLINE RAILROADS: THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY, ET AL., AND LOUISVILLE AND NASHVILLE RAILROAD COMPANY,

Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

Petitioners, George P. Baker, Richard C. Bond, and Jervis Langdon, Jr., Trustees of the Property of Penn Central Transportation Company, Debtor (Penn Central), respectfully pray that a writ of certiorari issue to review the judgment on reargument of the United States Court of Appeals for the Third Circuit entered on October 9, 1973, as amended by its judgment entered on November 6, 1973 (rehearing denied November 7, 1973), to the extent that it reversed in part Order No. 613 of the United States District Court for the Eastern District of Pennsylvania, entered in

the Debtor's reorganization proceedings pursuant to Section 77 of the Bankruptcy Act (11 U.S.C. § 205) on March 16, 1972.

OPINIONS BELOW.

The opinion of the United States District Court for the Eastern District of Pennsylvania is reported at 340 F. Supp. 857 (E.D. Pa. 1972) and is printed in the Appendix (A1). The opinion of the Court of Appeals for the Third Circuit, filed October 9, 1973, as amended by its order filed November 6, 1973, is not reported. The opinion and amending order are printed in the Appendix (A18, A48).

JURISDICTION.

The judgment on reargument of the United States Court of Appeals for the Third Circuit was entered October 9, 1973, and an amended judgment was entered on November 6, 1973. Petitions for rehearing were denied by order dated November 7, 1973 (A53).

This Court's jurisdiction is invoked pursuant to 28 U.S.C. § 1254(1).

QUESTION PRESENTED.

Whether the United States Court of Appeals for the Third Circuit erred in reversing a prior decision of its own and holding that a trust, and not a debtor-creditor, relationship exists, where a railroad accounts for freight and passenger charges for interline transportation under rules and customs among railroads whereby the railroads deposit such funds with their general funds and use the same for their general corporate purposes, with the accounting railroad responsible for paying other carriers their shares at a later date, whether or not it has collected the charges.

STATEMENT OF THE CASE.

Penn Central filed its petition for reorganization under Section 77 of the Bankruptcy Act in the United States District Court for the Eastern District of Pennsylvania, No. 70-347, on June 21, 1970.

Among amounts owing to Penn Central on that date was $4.3 million due and payable from other railroads, the respondents herein, on account of certain interline balances under the Accounting Rules of the Association of American Railroads, to which Penn Central and the respondent railroads are parties (Jt. App. 34a).[1]

The so-called interline accounts or balances are amounts which arise from the performance of through transportation by more than one railroad, and the procedures for striking such balances and accounts are embodied in the accounting rules of the Association of American Railroads, to which both Penn Central and respondents have agreed and by which they are bound (Jt. App. 69a-70a). The interline accounts involved were for freight and passenger charges, per diem, switching, overcharge, and car repairs. In refusing to pay such indebtedness to Penn Central, the respondent railroads set off the amounts owed by them against pre-bankruptcy interline balances and other amounts owed to them by Penn Central.

In Order No. 1 in Penn Central's reorganization proceedings, entered on June 21, 1970, it was provided (paragraph 10):

> "All persons, firms and corporations . . . holding for the account of the Debtor deposit balances or credits be and each of them hereby are restrained and enjoined from selling, converting or otherwise disposing of such

1. The reference "Jt. App. —a" is to the Joint Appendix filed in the Court of Appeals.

collateral, deposit balances or other credits, or any part thereof, or from offsetting the same, or any thereof, against any obligation of the Debtor, until further order of the Court."

Order No. 1 further provided (paragraph 3) that the Debtor was authorized in its discretion to pay, among other things, all current accounts and balances owing by the Debtor.

Thereafter, Burlington Northern, Inc. and other respondents sought and obtained from the Reorganization Court, under threat of retaliation against Penn Central, an order (Order No. 9) which required Penn Central to pay interline balances which were first stated or presented and due to be stated or presented on and after July 1, 1970. Aside from payments for the future, this order had the effect of requiring Penn Central to pay interline balances which accrued prior to June 21, 1970, to the extent that they were first stated or presented and due to be stated or presented on and after July 1.

Nevertheless, the respondent railroads, and other railroads which subsequently discontinued the practice, proceeded to set off the interline balances that they owed Penn Central against pre-bankruptcy interline balances and other accounts owed to them by Penn Central, including the freight account for the month of May, 1970. Although the accounting rules then precluded the netting of different interline accounts, the respondent railroads set off without regard to the particular accounts involved, and even included miscellaneous bills, which are not interline accounts.

Faced with being deprived of much-needed revenue, Penn Central's Trustees petitioned the Reorganization Court for relief. The respondent railroads counterclaimed, seeking declaration of a trust and payment or an equitable

lien against all the assets of Penn Central with respect to freight and passenger balances owed by Penn Central and payment of other interline balances owed by Penn Central or the establishment of an equitable lien against all its assets.[2] The District Court rejected these contentions and entered its Order No. 613, enjoining further setoffs, from which the respondent railroads appealed to the Court of Appeals.

The Court of Appeals held that the freight and passenger balances owed by Penn Central to respondents constitute a trust and entered a judgment reversing the order of the District Court as it operates to preclude respondents from offsetting amounts they owe Penn Central against amounts Penn Central owes them for freight and passenger services. The judgment required Penn Central to pay respondents immediately any remaining balances due for these accounts. In all other respects, the order of the District Court was affirmed and the cause remanded to the District Court for entry of an order consistent with the Court of Appeals opinion. After Penn Central filed a petition for rehearing, pointing out that a requirement of "immediate" payment of remaining balances could result in a cessation of Penn Central's operations, the Circuit Court, on November 6, 1973, entered an amended judgment eliminating the "immediate" requirement. On November 7, 1973, the Court denied the petition for rehearing.

The factual situation with respect to the freight and passenger interline accounts under the rules and the practices and customs observed by the railroad industry is that when a railroad collects freight charges, from the consignor

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2. In addition, the respondent railroads sought, under their interpretation of Order No. 9, payment of car repair accounts, passenger balances, and miscellaneous bills, for which payment, not statement or presentation of account, was due after July 1, 1970.

on a prepaid shipment or from the consignee on a collect shipment, the funds so collected are deposited in the general bank accounts of the railroad. They are not identified as attributable to any particular transaction, and are used by the railroad for disbursements of any character in the ordinary course of its business (Jt. App. 71a). This also applies to the collection of passenger charges by the carrier selling the tickets.

The destination railroad is the accounting railroad and settles with other railroads involved in interline freight shipments, whether such shipments are prepaid or collect. All revenue waybills recorded by the destination railroad in a particular month are included in the interline accounts for that month, and drafts are then drawn on the owing railroad even though the freight charges have not been collected from the shipping public. Where charges are prepaid, the destination carrier is obligated to pay intermediate carriers even though it has not yet been paid by the originating carrier (Jt. App. 71a). The railroad which sells a passenger ticket for interline transportation settles with the other railroads involved and the settlements include all tickets sold, even though the selling carrier has not as yet been paid by the customer. In the settlement and payment of these and other interline accounts, interest does not accrue. The drafts for such settlements are paid out of a railroad's general funds.

In addition to Penn Central, The Central Railroad Company of New Jersey, Lehigh Valley Railroad Company, and Reading Company, in the Third Circuit, Boston and Maine Corporation, in the First Circuit, Lehigh and Hudson River Railroad, in the Second Circuit, and Erie Lackawanna Railway Company and Ann Arbor Railroad Company, in the Sixth Circuit, are in reorganization under Section 77 of the Bankruptcy Act. The same issues as those

involved in the instant case are presently pending in the Erie Lackawanna reorganization proceeding.

At the inception of the Central Railroad Company of New Jersey reorganization proceeding, it was held, upon the same rules and practices as those involved here, that freight charges are not held in trust by the collecting railroad, and this holding was affirmed by the Court of Appeals for the Third Circuit because of its "sound reasoning." *In re Central Railroad of New Jersey*, 273 F. Supp. 282 (D.N.J. 1967), *aff'd per curiam*, 392 F. 2d 589 (3d Cir. 1968)[3] The Court of Appeals for the Third Circuit has now reversed this holding (A34).

Although they were free to do so, the railroad parties to the AAR mandatory accounting rules made no changes in such rules in the intervening six years since the Central Railroad of New Jersey decision to require segregation of funds collected on account of freight and passenger charges, to bar the collecting carrier's use of such funds, or otherwise to evidence an intent to create a trust. Changes in such rules were made in other respects, such as permitting the offset of one account against another, effective January 1, 1972, but such changes gave no separate treatment to freight and passenger balances vis-a-vis other accounts.

During the course of the administration of Penn Central's estate, its Trustees have paid all post-reorganization interline balances as they became due, but they have no reserve for the payment of the Debtor's pre-bankruptcy obligations. The Trustees' stringent cash position has even required the deferral of payment of post-bankruptcy

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3. In that decision, the CNJ Reorganization Court stated: "The relationship among the several carriers engaged in an interline freight movement is that of debtor and creditor. *The AAR rules create no other relationship.*" 273 F. Supp. at 288 (Emphasis supplied)

administration expenses such as taxes,[4] now totaling over $200 million.

Also, the Trustees have borrowed $100 million under the Emergency Rail Services Act of 1970, 45 U.S.C. § 661 *et seq.*, which obligation is secured by a direct first lien on all the assets of the Debtor's estate.

4. See *In re Penn Central Transportation Company*, 325 F. Supp. 294 (E.D. Pa. 1970), *aff'd* 452 F.2d 1107 (3d Cir. 1971), *cert. den.* 406 U.S. 944 (1972).

REASONS FOR GRANTING THE WRIT OF CERTIORARI.

1. The Decision of the Third Circuit Is in Conflict With a Decision of the Sixth Circuit.

The decision of the Court of Appeals for the Third Circuit that freight and passenger pre-bankruptcy interline balances owing by Penn Central were held in trust and entitled to payment in preference to the claims of other creditors, both pre-bankruptcy and post-bankruptcy, is in conflict with the decision of the United States Court of Appeals for the Sixth Circuit, *In re Tennessee Central Railway Company*, 463 F.2d 73 (6th Cir. 1972), *cert. den.* 409 U.S. 893 (1972). In that case, the Court held that the claim by the United States on account of a Reconstruction Finance Corporation loan had preference to the assets of the Tennessee Central over the claims of its interline creditors.

In the *Tennessee Central* case, the District Court had held that interline balances owing to other railroads had a priority under the "six-month" rule over the claim of the United States for the Reconstruction Finance loan. The Court stated "There is no argument, however, that the Tennessee Central held these funds in trust for the other carriers," and quoted from that portion of the District Court decision in the *CNJ* case that interline freight balances are not trust funds, but that they may be entitled to preferential treatment under the six-month rule. The Court concluded:

> "Thus, although the funds are not held in trust, the carriers can be said to have an equitable right to a priority in their recovery, if all other requisite requirements are met." 316 F. Supp. 1103, 1110 (M.D. Tenn. 1970)

On appeal by the United States, the Sixth Circuit reversed the lower court's holding of priority and accorded a priority to the loan claim of the United States. The result there is clearly in conflict with the decision of the Third Circuit. If interline freight and passenger balances are trust funds, the United States could not be afforded a priority to that extent, because the assets would be the property of the connecting railroads and not of the debtor's estate.

On the Government's appeal to the Sixth Circuit, the railroads, having succeeded in obtaining a priority in the court below, did not argue against the holding of the District Court that there was no trust. Subsequently, because of the pendency of the trust issue in the Third Circuit, the railroads involved in the *Tennessee Central* case attempted to have distribution of that estate delayed until a final determination of the issue in the *Penn Central* case, or to have that Court declare a trust on interline freight balances. The Tennessee Central Reorganization Court denied those requests, stating, *inter alia*:

> "1. The Court, as heretofore pointed out, did in fact consider the trust fund theory in its August 1970 opinion and rejected it as being unsound. (See 316 F. Supp. at 1110)." (Memorandum Opinion, p. 3, entered May 24, 1973, *In the Matter of: Tennessee Central Railway Company, Debtor*, U.S. Dist. Ct. M.D. Tenn. No. Bk. 67-2263)

This latest decision is now pending on appeal to the Sixth Circuit (No. 73-2040), and the appellant railroads are urging that Court to withhold any action in the premises until this Court acts on the issue in the instant case.

In contrast to the Sixth Circuit, the Third Circuit, by declaring a trust, would accord a priority to freight and

passenger interline balances and payment thereof, not only in preference to the claims of other pre-bankruptcy creditors, but also over post-bankruptcy claims, which are expenses of administration. These include the $100 million loan guaranteed by the United States, which has "the highest lien on the railroad's property, and priority in payment under the Bankruptcy Act." (45 U.S.C. § 662(c))

2. A Determination by This Court of the Status of Pre-Bankruptcy Freight and Passenger Interline Balances Is Necessary to the Proper Administration of Section 77 of the Bankruptcy Act.

This Court has not determined the status of pre-bankruptcy freight and passenger interline balance claims in a proceeding under Section 77 of the Bankruptcy Act. Prior to the instant decision of the Court of Appeals for the Third Circuit, the law of the Circuit was that such interline balances were debts of the carrier in reorganization, not a trust. *In re Central Railroad of New Jersey, supra.* During the period of over six years before the reversal of the *Central Railroad* decision, Penn Central, Lehigh Valley Railroad, and Reading Company, all in the Third Circuit, followed Central Railroad of New Jersey into reorganization, and in each instance the law of the Circuit had supposedly established the status of pre-bankruptcy freight and passenger interline balances as debts of a railroad in reorganization, leaving only the possible application of the "six-month rule" with respect to any claimed priority over other creditors. Now, under the reversal by the Court of Appeals of the *Central Railroad* case, not only the respective rights of pre-bankruptcy creditors have been changed, but also the rights of post-bankruptcy creditors, such as the United States and taxing authorities (*supra*, p. 8), whose claims are expenses of administration of the Debtor's Trustees.

Also, as previously noted, there are four other operating railroads in process of reorganization under Section 77 in three other Circuits, and there is an action pending in the Erie Lackawanna's reorganization proceeding in the Sixth Circuit, where the *Tennessee Central* case was decided.

It is therefore of utmost importance to the proper administration of Section 77 of the Bankruptcy Act that the status of pre-bankruptcy freight and passenger interline balances be resolved by this Court.

Moreover, the legal status to be accorded freight and passenger balances under the railroad industry's accounting rules has never been resolved by this Court, and billions of dollars are divided annually pursuant to these rules.

3. The Court of Appeals Erred in Holding That Interline Freight and Passenger Charges Collected by Penn Central Constituted a Trust.

Although the Court of Appeals recognized that under the law of trusts the creation of a trust for monies collected by one for another depends on the intent of the parties, the Court's holding of a trust with respect to the collection of freight and passenger interline charges was contrary to the "intent" evidenced by the facts and circumstances surrounding the collection of such charges. Indeed, in spite of the Court's statement that the "parties' manifestation of intention ultimately controls whether or not a trust relationship exists" (A28), the Court showed its preference by first observing that a "common sense" interpretation of the AAR interline accounting system would "indicate" that the funds collected are held in trust until transmitted (A27). Similarly, the Court states that the collection by Penn Central as an agent of money due

and owing other railroads "suggests a trust," citing Restatement (Second) of Trusts, Section 12, comment h (1959) (A28-A29).

The Court's "common sense" observation not only begged the question of intent of the parties, but also ignored the fact that the AAR rules were not changed following that Court's affirmance of the holding in *In re Central Railroad of New Jersey, supra,* that the collection of interline freight and passenger charges under such rules did not constitute a trust. The Court should have recognized that if the railroads intended to impress the collection of such charges with a trust, they would have amended the AAR mandatory accounting rules.

As stated above, changes have been made in the rules since the *CNJ* decision, but no change was made to require segregation of the funds collected, bar the collecting carrier's use of the funds, or in any sense create a trust. Nor was any separate treatment afforded to freight and passenger balances vis-a-vis other interline accounts in the changes that were made, another indication that the railroad industry regarded all of the accounts as debts or choses in action. The absence of a change in such rules following the decision in the *CNJ* case provides persuasive evidence that the railroads did not intend to create a trust relationship on freight and passenger charges, quite to the contrary. The parties were content to a continuation of the same AAR rules after the *CNJ* holding. The Court should have so found in the instant case in evaluating the parties' intent.

In citing the Restatement and stating that the collection by Penn Central as an agent of money due and owing other railroads "suggests a trust," the Court failed to recognize that part of the Restatement that says:

> "He is not a debtor to the principal, *unless the principal manifested an intention that the agent should be*

> *entitled to use the money as his own*'' (emphasis supplied)

which is the situation here.

In considering intent of the parties, the Court found that the absence of a provision for interest ''indicates'' the presence of a trust relationship, ''although not conclusive.'' The absence of a provision for the payment of interest by one who collects or holds the funds of another is certainly not conclusive, for if it were, every checking account would by that standard have to be considered a trust. The absence of interest is not surprising in a situation such as this, where each railroad collects funds as agent for others, and each has the unrestricted use of the funds it collects.

The Court then stated that while commingling indicates a debtor-creditor relationship and not a trust, it is only ''one indication,'' and again, ''not necessarily conclusive'' (A29). The Court discounted commingling as a factor because of the ''unique and complex interline railroad system,'' citing the AAR rules, but ignored the fact that those rules have made no attempt to set up a trust. On the contrary, they have permitted not only commingling but also unrestricted use by each railroad of all charges collected.

Although mentioned in its opinion (A26, A30), the Court gave no consideration to the fact that an accounting railroad is obligated to include in its settlements with other railroads all freight and passenger charges for transportation during the month, even though such charges have not been collected from the shipper or passenger, or, in the case of prepaid freight shipments, from the originating carrier. The settlements for freight balances are based on waybilled shipments and for passenger balances on

tickets sold, not on amounts actually collected. To the extent of the difference, there could be no corpus on which to impress a trust.

The Court also referred to *dictum* in *Southern Railway Company v. United States*, 306 F. 2d 119 (5th Cir. 1963), as indicating a trust for interline balances, but ignored the fact that there the collecting carrier was not authorized to use the funds collected, settlements for which were on a weekly basis.

After its pro and con discussion, which provided no meaningful basis for its conclusion, the Court swept aside the only case directly in point, *In re Central Railroad of New Jersey, supra.* In so doing, the Court gave no consideration to the rationale of that decision nor to its "sound reasoning" as previously found by a panel of the Court, and reached a conclusion contrary to the facts and circumstances presented.

CONCLUSION.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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Appendix.

IN THE

UNITED STATES DISTRICT COURT

FOR THE EASTERN DISTRICT OF PENNSYLVANIA

In Proceedings for the Reorganization of a Railroad.

No. 70-347

In the Matter of

PENN CENTRAL TRANSPORTATION COMPANY,
Debtor

OPINION AND ORDER NO. 613

[Re: Trustees' Petition to Compel
Payment of Interline Balances]

FULLAM, *J.* March 16, 1972

The Trustees have petitioned for an order directing certain rail carriers (interline railroads) to pay interline balances owing to the Debtor. The Trustees contend that these interline railroads have violated paragraph 10 of Order No. 1 in these proceedings, which provides in part:

> "All persons, firms and corporations . . . holding for the account of the Debtor deposit balances or credits be and each of them hereby are restrained and enjoined . . . from off-setting the same, or any thereof, against any obligation of the Debtor, until further order of this Court."

There is no substantial dispute that the interline railroads and the Debtor have claims against each other, nor is there any substantial dispute as to the amount of these claims. The issues to be resolved herein, among others, are whether the claims of the interline railroads extinguish the Debtor's claims; assuming the Debtor's claims are not extinguished, whether the interline railroads are entitled to resort to the remedy of set-off against such claims; whether the interline railroads are entitled to an equitable lien on the estate of the Debtor for the amount of any claims remaining unpaid; and whether Order No. 9 in these proceedings requires additional payments to be made by the Debtor to the interline railroads.

I. The Factual Background.

A. The System of Interline Accounts.

The nation's railroads function in many ways as a single system. For example, a shipper or receiver pays one railroad for services of carriage for the entire shipment, although the shipment may travel over many different railroads; a railroad car may travel over the lines of many different railroads, and be used by each of them, before it again returns to the possession of the owning railroad; and a shipper whose freight may have been damaged in shipment by one of several carriers may apply to any of them for payment of his claim. The railroads have created a system of accounting and periodic settlement of accounts to facilitate this manner of operation. The accounting for various types of rail service rendered to the public or to other railroads results in "interline accounts," and the striking of balances between the railroads with respect to these interline accounts results in "interline balances."

Each of the accounts is settled separately; there is no netting of the balances in different accounts.[1]

The present petition involves six interline accounts; Freight, Passenger, Per Diem, Switching, Overcharge and Car Repairs. In addition, the respondents make reference to two other accounts: the Loss and Damage Account and an account encompassing "Miscellaneous Bills" for services, facilities and supplies furnished by one railroad to another. These accounts are described below.

Freight.

Where a freight shipment moves over more than one railroad, each road is entitled to be paid for the part of the carriage it performed. The destination carrier (who either collects from the consignee or debits the originating carrier if the shipment is prepaid) has the responsibility of computing from the waybill issued by the originating carrier the amounts due to the originating carrier and to the intermediate carriers. Rule 110A. These computations are made for each waybill reported by the destination carrier's agent in a particular month regardless of whether the freight charges have actually been paid.

The results of these computations ("abstracts" and "recapitulations of abstracts") must be sent to the other carriers by the 18th of the month following the month in which the waybill was issued. Rule 145. The Rule contemplates that at least the net figures should reach the other carriers by the 20th of that month. Rule 146. [The calculation of the account also may include corrections from freight accounts rendered as many as 36 months earlier.

1. This system of accounts is established and governed by rules promulgated by the Association of American Railroads ("AAR"), of which the railroads in this proceeding are members. The "Rules" referred to in this Opinion governing each account and the publications in which they are found are listed in the Appendix.

Rule 170.] After accounts are rendered, net balances are struck between the carriers. These balances are subject to immediate sight draft. Rule 149.

Passenger.

Interline passenger accounts are prepared by each ticket-selling carrier. The accounts so prepared are exchanged by mail on or before the last day of the month after the month in which the sales were reported. Rule 1. Here, too, settlement of the net interline account balances is subject to immediate sight draft. Rule 9.

Overcharge.

The Overcharge Account reflects claims made by shippers for refunds in situations where too much was charged. A shipper may make such a claim against any carrier participating in the carriage. That carrier investigates the claim and pays it if it finds it valid. The paying carrier then charges the responsible carriers under the rules. These accounts are to be stated by the 10th of the month following the one in which the claim was settled; and settled by draft on or after the 25th of the same month on a gross basis. Rule 91A. It is the Debtor's policy to issue drafts against other carriers only for amounts it has actually paid to shippers.

Loss and Damage.

The same principles governing the Overcharge Account apply to the stating and settling of the Loss and Damage Account, Rule 152, except that the paying carrier must have actually paid before charges can be stated against another carrier. Rule 150.

Car Repair.

The National Safety Appliance Act mandates that each carrier perform necessary repairs on cars found to be defective. 45 U. S. C. A. § 13 (Supp. 1972). Bills for car repairs are required to be rendered no later than the last day of the month following the month in which the repairs were made. Each month's bill may include charges for car repairs made within the preceding 12 months. Settlement is made on a gross basis by draft on or after the 15th of the next month. Rule 23.

Per Diem.

The Per Diem Account reflects the daily rental charge for the use of railroad cars belonging to another carrier. Reports of per diem due must be forwarded to the owning carrier by the 10th day of the second month following the month in which the per diem accrued. Rules 5, 6. The net balances of these accounts are subject to draft immediately thereafter.

Switching.

While the Switching Accounts are not governed by any mandatory rules, Freight Recommendatory Rule 408 sets forth the general intent of the industry concerning their settlement. It provides that the Switching Accounts that can be settled on a carrier-to-carrier basis (many apparently cannot) are to be stated by the 18th of the month following the month for which settlement is being made. Settlement is made by draft for the net balance due, not later than the 25th day of that month.

Miscellaneous Bills.

In addition to the transactions encompassed by the preceding accounts, interline railroads render bills to each

other for such things as the joint operation of passenger terminals and freight yards, refrigeration services and the destruction of one railroad's equipment on another carrier's lines. These miscellaneous bills are settled by check. Disbursements Mandadatory Rule 3 provides for the form of such bills; however, there are no general rules governing the time in which they should be rendered or paid.

B. *Proceedings Leading to the Present Petition.*

Paragraph 3 of Order No. 1 in these proceedings, entered June 21, 1970, the date Debtor filed for reorganization, provides in part:

> "The Debtor is authorized in its discretion, from time to time until further order of this Court, out of funds now in its possession or hereafter coming into its hands, to pay . . .
>
> "B. All other current expenses and costs hereafter necessarily incurred in operating, maintaining and preserving its railroad and other properties, collecting the revenues, and conducting the business of the Debtor . . . including . . . all wages . . . all interline accounts and balances owing by the Debtor . . . and all accounts for services, materials and supplies rendered or furnished to the Debtor."

The Debtor declined to pay any interline balances on or after June 21, 1970. On June 24, 1970, Burlington Northern, Inc. moved to amend Order No. 1 to require the Debtor to pay interline balances. A hearing was held on July 1, 1970, on that motion. At the conclusion of the hearing, the Court invited counsel to submit a form of order which would make mandatory the payment of post-petition interline balances stated from and after that date. That form

of order became Order No. 9. The Court expressly left open the question of the status of the interline balances not required to be paid by that Order (Tr. 69).

II. The Merits.

The Trustees assert that the interline railroads have not paid amounts owing the Debtor under the applicable AAR Rules, for the six interline accounts mentioned above. As of the date of the hearing, November 29, 1971, it was undisputed that, apart from a few comparatively minor items in dispute, these interline balances amounted to approximately $3.4 million (Tr. 4064-65, 4068, 4077). The Trustees contend that the interline railroads are not entitled to set off their claims against this amount, and that the interline railroads should be compelled to pay the balances owing to the Debtor.

The interline railroads[2] make four responses to the Trustees' petition:

Their first defense is in the nature of a counterclaim which, if sustained, would extinguish the claims of the Trustees. They assert that the Debtor owes them approximately $13.5 million and that the part of this amount attributable to the freight and passenger accounts must be considered a trust fund and that they are entitled to be paid that amount less what they owe the Debtor. While they do not contend that the other part of the $13.5 million which is attributable to the other interline accounts is a

2. The term "interline railroads" as used in this Opinion refers collectively to the respondents to the Trustees' petition. The respondents have joined together in three groups: The Committee of Interline Railroads (the largest group); the Louisville and Nashville Railroad Company, and the three railroads joining with it; and the Indiana Harbor Belt Railroad. For the most part, the arguments made by one group are applicable to the others. Therefore, it will not generally be necessary to consider which group makes a particular argument.

trust fund, they do contend that equitable principles entitle them to payment of this amount.

Second, the interline railroads contend that they are entitled to resort to the remedy of set-off against the claims of the Debtor. The Louisville and Nashville Railroad Company and the railroads joining with it expressly challenge the jurisdiction of this Court to enjoin set-offs against the Debtor's claims.

Third, the interline railroads contend that to the extent that their claims remain unpaid, they are entitled to an equitable lien on the estate of the Debtor.

Fourth, they counterclaim for amounts which they contend the Debtor is required to pay pursuant to Order No. 9 in these proceedings.

A. The Right of the Interline Railroads to Payment of their Claims.

The interline railroads' first contention is that the amounts owed by the Debtor are trust funds. It is argued that pursuant to the Rules governing the freight and passenger accounts, the Debtor has collected money which belongs to the interline railroads and that these monies are "trust funds" which should be paid over to the interline railroads. Moreover, it is argued that because statutes and ICC regulations require the interline railroads to deal with the Debtor, the interline railroads' claims should be accorded a priority higher than the trade creditor who could choose whether or not to deal with the Debtor.

With respect to the trust fund argument, the interline railroads have cited various cases in support of the proposition that interline balances, representing the portion of monies collected by the Debtor for freight and passenger service performed by the interline railroads, are trust funds. However, two of the cases cited, *Atlantic Coast*

Line R. Co. v. Pennsylvania R. Co., 12 F. Supp. 720 (E.D. Pa. 1935); *Thompson v. Baltimore and O. R. Co.*, 80 F. Supp. 570 (E.D. Mo. 1948), *aff'd* 180 F.2d 416 (8th Cir. 1950), hold only that where several railroads are involved in the carriage of a shipment and one of them, not in reorganization, has received payment for the entire carriage, the others may maintain an action in equity for their fair share. The exact nature of the revenues, *i.e.*, whether or not the revenues were "trust funds," was not an issue in either case. And the term was not used by either court as a basis of its holding but rather simply part of its analysis of the case as an action in equity. *Atlantic Coast Line R. Co. v. Pennsylvania R. Co., supra,* at 722-23; *Thompson v. Baltimore and O. R. Co.*, 80 F. Supp. at 572, 575; 180 F.2d at 421.

In the third case relied on by the interline railroads, *Southern Ry. Co. v. United States,* 306 F.2d 119 (5th Cir. 1962), the court based its statement that interline freight balances could acquire a " 'trust' character" "on a line of cases which hold [that] funds which have been wrongfully applied by the Court appointee during the pendency of a receivership, bankruptcy or reorganization," may become trust funds. *Id.* at 124-25, n. 5. This is obviously not the situation which is presented in this proceeding and, in any event, since the court in *Southern* ultimately determined that a priority should not be accorded to the interline balances under the trust fund theory, the court's statement can hardly be regarded as the holding of the case.

The interline railroads also assert that because they are compelled to deal with the Debtor, some special equities should arise in their favor. The interline railroads appear to assert in their memorandum of law that they were legally compelled to deal with the Debtor so as to

allow interline balances to become owing to them by the Debtor. (Pp. 27-29, 38.)

While it is true that the interline railroads are required, for example, to accept from each other and to transport freight and passenger traffic and to correct unsafe conditions found on each other's cars, there is no requirement that interline railroads extend credit to each other. In fact, in proceedings leading to the entry of Order No. 9, the interline railroads detailed measures that could be taken to put a railroad, that could not be counted on to make its interline balance settlements, on a "cash" basis. *E.g.*, Tr. 23-26; Memorandum of Burlington Northern, Inc. (Document No. 18) at 5. Moreover, it is apparent that the interline railroads' description of such measures did not exhaust the list of measures that could be used to put a railroad on a cash payment rather than a credit basis. *See Southern Ry. Co. v. Flournoy,* 301 F.2d 847, 855-56 (4th Cir. 1962) (security deposit; creditor railroads' control of car movements).

Therefore, the interline railroads having offered no persuasive authority to the contrary, this Court is bound to follow *In re Central Railroad of New Jersey,* 273 F. Supp. 282 (D.N.J. 1967). In that case, the arguments made here were presented, and the issues thus raised were resolved squarely against the interline railroads. The Third Circuit affirmed that decision *per curiam,* 392 F.2d 589 (3d Cir. 1969), expressly adopting the district court's reasoning. Accordingly, I have concluded that the interline railroads are not presently entitled to payment of the pre-petition interline balances owed by the Debtor.

B. *Control of the Exercise of the Right of Set-Off.*

The interline railroads next assert that they should be accorded the right to offset their claims against the Debtor against the amounts they owe.

Having determined that equitable principles do not extinguish Debtor's choses in action running against the interline railroads, it is necessary to determine whether this Court can and should enjoin the exercise of the remedy of set-off against those choses in action. The issue of this Court's jurisdiction to enjoin set-offs against choses in action held by the Debtor is no longer in question. *In the Matter of Penn Central Transportation Company, Debtor,* First Wisconsin National Bank, et al., Appellants, Nos. 19,340-19,346 (3d Cir., Dec. 23, 1971); *see In the Matter of Penn Central Transportation Company, Debtor,* Re: Application of the Trustees for an Order Directing Certain Shippers and Others to Pay Amounts Owing to the Debtor, Opinion and Order No. 571 (E.D. Pa., Jan. 31, 1972).

Whether set-offs should be enjoined presents a more substantial and more difficult issue. Many of the considerations discussed in the "shippers" case, above, are relevant here. The claims of the interline railroads arose out of transactions which were a vital part of the Debtor's day-to-day business. Such claims would probably fall within the so-called "six-months' rule" which has been held applicable in § 77 proceedings, and would likely be entitled to a high priority. *E.g.,* 5 *Collier on Bankruptcy,* ¶ 77.21 nn. 27-29 (1970).

But, just as in the "shippers" case, several factors persuade me that set-offs should be prohibited at this time. First, to permit set-offs could discriminate against the many other suppliers of services and equipment to the Debtor. At the hearing on July 1, it was estimated that pre-petition claims by these suppliers would aggregate over $200 million. In view of the substantial uncertainty that the interline railroads will be able to establish a distinction between their claims and the claims of the Debtor's trade creditors, it would not be appropriate to permit the interline railroads to resolve the question favorably to themselves through the

self-help remedy of set-off prior to determination of the question in the proof of claims program.

Second, the Debtor's cash position must be considered. *See* the "shippers" Opinion, *supra* at 9. The Debtor is still unable to pay all of the costs of present operations, *e.g.*, taxes and leased-line rentals.

C. *The Claim for an Equitable Lien.*

The interline railroads' third contention is that they are entitled to an equitable lien on the Debtor's estate to the extent that their claims remain unpaid. The interline railroads argue, in essence, that even if they are not entitled to payment now on the basis of the various equitable theories discussed previously, at the least they should be entitled to an equitable lien. If this contention were sustained, it would be equivalent to the finding that the interline railroads are entitled to the payment of their claims from the Debtor's estate immediately after administration expenses, ahead of all other creditors.

The arguments that equitable principles entitle the interline railroads to immediate payment of their claims were rejected previously. But, whether an application of these principles should entitle the interline railroads to a priority, and what that priority might be, presents a different question. It appears, however, for a number of reasons, that decision of this question should await the classification of the interline railroads' claims in the proof of claims program. First, the Debtor's other creditors who may be affected by a decision of this question have not had an opportunity to express themselves with respect to it. Allowing an opportunity for such expression would be particularly important here where the interline railroads' entitlement to an equitable lien is open to serious question. Indeed, neither of the two cases cited by the interline rail-

roads as directly supporting their contention, *In re Tennessee Cent. Ry. Co.*, 316 F. Supp. 1103 (M.D. Tenn. 1970), *Southern Ry. Co. v. Flournoy*, 301 F.2d 847 (4th Cir. 1962), distinguished between claims of interline railroads and claims by trade creditors. Both cases dealt with the application of the six months' rule to claims of creditors, including interline railroads. Given the uncertainty of the proposition which the interline railroads advance, there can be no justification at this time for placing their claims ahead of the claims of the Debtor's trade creditors.

Second, whatever may be the situation in the reorganization of a smaller railroad, *Southern Ry Co. v. Flournoy, supra* at 850, the classification of claims in this reorganization presents complex and difficult issues. Questions of this importance should be adjudicated in the context of the general program for determining the rights of creditors. For the two foregoing reasons, therefore, the application of the interline railroads for the imposition of an equitable lien on the estate of the Debtor will be denied without prejudice.

D. *The Counterclaim for Payment Under Order No. 9.*

The interline railroads' counterclaim is based on the contention that the Trustees have not paid all of the accounts which they were directed by Order No. 9 to pay. The pertinent language of the order requires payment of " . . . interline accounts and balances *first stated or presented and due to be stated or presented for settlement* on or after [July 1, 1970]." It is argued that this language requires payment of certain additional Car Repair, Passenger, and Miscellaneous Accounts which were or should have been billed before bankruptcy, but as to which sight-drafts were not due to be presented until after the date of Order No. 9.

This interpretation equates presentation of a draft and statement of the account; more importantly, it overlooks the word "first" in the Order. Accounts which were either stated or presented prior to the date of Order No. 9 were not required by that Order to be paid, and thus respondent's contentions with respect to the Car Repair and Passenger accounts are clearly without merit.

The Miscellaneous Bill Account presents different issues. The interline railroads assert that such bills aggregating approximately $1.9 million were, in normal course, first presented to the Debtor after the crucial date, and this fact is not substantially disputed. The question is whether this account was intended to be included in Order No. 9.

The Trustees argue that Order No. 9 relates only to accounts which are stated and settled in accordance with AAR Rules, and that the Rules do not govern settlement of Miscellaneous Bills, but only their form. Admittedly, however, the language of Order No. 9 can be more broadly interpreted.

It must be emphasized that the wording of Order No. 9 was drafted by counsel for the parties, by agreement. The Court was not called upon to rule, and did not consider, the specific application of the Order to the Miscellaneous Account. It now appears that the parties either did not consider this question, or at any rate are presently unable to establish that there was agreement on the question. Accordingly, a present decision as to the correct interpretation of Order No. 9 should be based upon the same considerations as if the underlying question were now presented to the Court for decision.

As discussed above, it can be persuasively argued that all of the claims of interline railroads should be treated no differently from the claims of trade creditors. Of all

of the interline claims, the Miscellaneous Bills most nearly resemble the claims of ordinary trade creditors. I have therefore concluded that Order No. 9 should not be construed as requiring payment of the Miscellaneous Account claims which are the subject of respondents' counter-claims.

E. *Remedy.*

To summarize, I have concluded that the interline railroads are not now entitled to payment of their claims or to the declaration of an equitable lien or a priority in respect of them; that the counterclaims should be rejected; and that the interline railroads should be enjoined for the present from setting off these claims against the claims of the Debtor.

Pursuant to the practice followed in the "shippers" case, *supra,* an order in general terms will be entered at this time, on the assumption that implementation can be accomplished by further specific directions if necessary.

APPENDIX.

Source of Rules Governing Interline Accounts.

Freight Account: Freight Mandatory Rules in *Railway Accounting Rules* published by the Accounting Division, Association of American Railroads (effective Oct. 1, 1969) and its Supplement (effective Sept. 1, 1970) [hereinafter *"Railway Accounting Rules"*].

Passenger Account: Passenger Mandatory Rules in *Railway Accounting Rules.*

Overcharge Account: Overcharge Mandatory Rules in *Railway Accounting Rules.*

Loss and Damage Account: Freight Claim Rules published by Freight Claim Division, AAR (1970).

Car Repairs Account: Disbursements Mandatory Rules in *Railway Accounting Rules;* Code of Car Service Rules, Circular No. OT-10-B (effective Jan. 1, 1968), published by Operating-Transportation Division, AAR; Code of Rules for the Interchange of Traffic (effective Jan. 1, 1969), published by Mechanical Division, AAR and its Supplements Nos. 1 and 2.

Per Diem Account: Disbursements Mandatory Rules in *Railway Accounting Rules;* Code of Per Diem Rules Circular No. OT-10-B (effective Jan. 1, 1968), published by Operating-Transportation Division, AAR.

Switching Account: Freight Recommendatory Rules in *Railway Accounting Rules.*

Miscellaneous Bills: Disbursements Mandatory Rules in *Railway Accounting Rules.*

ORDER NO. 613.

AND Now, this 16th day of March, 1972, it is ORDERED that:

1. The Petition of the Trustees for Order Directing Rail Carriers to Pay Interline Balances is GRANTED IN PART, and the respondents in this proceeding are enjoined, until further order of this Court, from setting off or attempting to set off against obligations due and owing to the Debtor on account of interline balances due in accordance with the Accounting Rules of the Association of American Railroads, any claim or claims which they may have against the Debtor for interline balances due from the Debtor in June or July, 1970, in accordance with said Accounting Rules, or other claims which arose prior to June 21, 1970, but any such claim or claims may be filed and proved in accordance with Order No. 164 in these proceedings. This Order shall be deemed to be without prejudice to the right of any such respondent to claim such priority as may be proper.

2. Order No. 9 in these proceedings does not require payment by the estate of the Debtor of bills from interline railroads for certain services, supplies and facilities referred to in the foregoing Opinion as "Miscellaneous Bills" and referred to in the "Memorandum in Support of Answer, Defenses and Counterclaims of the Committee of Interline Railroads . . . " as "Schedule A Accounts."

JOHN P. FULLAM,

J.

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

Nos. 72-1436, 72-1437, 72-1438

In the Matter of:
PENN CENTRAL TRANSPORTATION COMPANY,
Debtor

Indiana Harbor Belt Railroad Company,
Appellant in No. 72-1436

Members of the Committee of Interline Railroads:
The Atchison, Topeka and Santa Fe Railway Company
Illinois Northern Railway
Burlington Northern, Inc.
Oregon Trunk Railway
Chicago, Milwaukee, St. Paul and Pacific Railroad Company
Chicago & North Western Railway Co.
Chicago, Rock Island & Pacific Railroad Co.
Peoria Terminal Co.
Delaware & Hudson Railway Co.
Greenwich & Johnsonville Railway Co.
Grand Trunk Western Railroad Co.
Kansas City Southern Railroad
Louisiana & Arkansas Railway Co.
Missouri-Kansas-Texas Railroad Co.
Missouri Pacific Railroad Co.
Texas & Pacific Railway Co.
Missouri-Illinois Railroad Co.
Chicago & Eastern Illinois Railroad
Norfolk and Western Railway Co.

New Jersey, Indiana & Illinois Railroad
Norfolk, Franklin & Danville Railway
Seaboard Coast Line Railroad Co.
Columbia, Newberry & Laurens Railroad Co.
Southern Pacific Transportation Company
San Diego & Arizona Eastern Railway
Northwestern Pacific RR
Portland Traction Company
Sunset Railway Co.
Visalia Electric Railroad Co.
St. Louis Southwestern Railway Co.
Southern Railway System
St. Louis-San Francisco Railway Co.
Alabama, Tennessee & Northern Railroad Co.
Quanah, Acme & Pacific Railway Co.
Union Pacific Railroad Co.
The Western Pacific Railroad Co.
Sacramento Northern Railway,
Appellants in No. 72-1437

Louisville and Nashville Railroad Company,
Appellant in No. 72-1438

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

Argued April 26, 1973
Before VAN DUSEN, ALDISERT and ROSENN, *Circuit Judges*

Reargued before the Court En Banc May 23, 1973

Present: VAN DUSEN, ALDISERT, ADAMS, GIBBONS, ROSENN and WEIS, *Circuit Judges*

W. Charles Hogg, Jr., Esquire
Edward C. Toole, Jr., Esquire
Clark, Ladner, Fortenbaugh and Young

William R. Glendon, Esquire
Frederick W. R. Pride, Esquire
William J. O'Brien, II, Esquire
George W. Brandt, Jr., Esquire
Royall, Koegel & Wells
for appellants

Paul R. Duke, Esquire
Richard R. Bongartz, Esquire
for appellee

OPINION OF THE COURT

(Filed October 9, 1973)

ROSENN, *Circuit Judge.*

The primary issues raised on this appeal are (1) whether freight and passenger revenues earned by railroad carriers for interline transportation or services but collected by Penn Central Transportation Company (Penn Central) in their behalf are held by it as trust funds, and (2) whether other interline services performed and expenses incurred by the interline carriers for Penn Central prior to its reorganization are entitled to current payment or offset. The district court in the Penn Central reorganization held that the interline railroads[1] (Interlines) were

1. An "interline railroad" is a railroad common carrier which cooperates with other railroads in the transportation of passengers or property over their lines, as required of all railroads engaging in interstate commerce by the Interstate Commerce Act, 49 U.S.C. § 1(4). The act provides in relevant part:

> It shall be the duty of every common carrier subject to this chapter to provide and furnish transportation upon reasonable

not entitled to current payment of their claims from the debtor or to a declaration of an equitable lien or priority. In addition, the court enjoined them from setting off these amounts against corresponding claims of Penn Central. In reviewing this order we are compelled to examine the complex accounting procedures of our national railroad systems and apply traditional principles of equity and trust law to the operating relationship among the railroads. We affirm in part and reverse in part.

I. The Background

The district court has succinctly described the system of accounts of interline railroads in its Opinion and Order No. 613 (E.D. Pa., No. 70-347, dated 3/16/72) as follows:

> The nation's railroads function in many ways as a single system. For example, a shipper or receiver pays one railroad for services of carriage for the entire shipment, although the shipment may travel over many different railroads; a railroad car may travel over the lines of many different railroads, and be used by each of them, before it again returns to the possession of the owning railroad; and a shipper whose freight may have been damaged in shipment by one of several carriers may apply to any of them for payment of his claim. The railroads have created a system of accounting and periodic settlement of accounts to facilitate this manner of operation. The accounting for various types of rail service rendered to the public or

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1. (Cont'd.)

request therefor, and to establish reasonable through routes with other such carriers, and just and reasonable rates, fares, charges, and classifications applicable thereto; . . . .

See, e.g., Southern Ry. Co. v. Flournoy, 301 F.2d 847, 854 (4th Cir. 1962).

> to other railroads results in "interline accounts," and the striking of balances between the railroads with respect to these interline accounts results in "interline balances." Each of the accounts is settled separately; there is no netting of the balances in different accounts.[1]

The methods of accounting and payment for interline services, however, are not controlled by statute but by industry accounting practices and rules.

The two basic categories of accounts here in issue are: (1) freight and passenger accounts; (2) other accounts, including (a) car repair accounts, (b) overcharge and loss and damage accounts, (c) per diem accounts, and (d) switching accounts. The accounting rules, described below in greater detail, differ for each of the categories. Basically, as to the first category, either the destination or the originating carrier collects the sums earned by each of the interline railroads and then allocates the appropriate amounts. As to the other accounts, the railroad that performs the service collects the amounts due it from the appropriate carrier.

Penn Central filed its petition for reorganization under section 77 of the Bankruptcy Act on June 21, 1970. In Order No. 1, approving the petition, entered on the same day, the court in paragraph 3(B) authorized Penn Central "in its discretion" to pay all interline accounts.[2]

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1. This system of accounts is established and governed by rules promulgated by the Association of American Railroads ("AAR"), of which the railroads in this proceeding are members. . . .

2. The order stated that Penn Central was authorized to pay all interline accounts and balances owing by Debtor, including amounts in respect of revenues from freight, passenger or other traffic interchanged with other carriers, and charges for repairs of, or loss damage to, rolling stock and equipment interchanged with other carriers, all claims for injuries, death or other loss or damage to passengers and others arising from the operation of

On June 24, 1970, one of the interline carriers, Burlington Northern, Inc., petitioned the district court to require Penn Central to pay interline accounts and balances.[3] At a hearing on July 1, 1970, Charles S. Hill, Penn Central's Vice-President-Comptroller, explained that Penn Central incurs an average net liability for interline charges of $24 million per month, owing $41 million and earning $17 million. On accounts stated in June 1970 which remain unpaid and are here in issue, he said it owed approximately $32.8 million, representing services performed in April and May 1970, and earlier.

Mr. Hill also endeavored to explain Penn Central's plans as they related to interline accounts. He described Penn Central's cash forecast for the month of July and, when asked whether interline balances had been provided for, replied:

> We have made provision on the expectation with the approval of the Court for meeting all of the interline accounts to be presented after or scheduled to be presented after June 30.

He explained that these payments would reflect services performed in June 1970 and earlier and that payment on them would begin July 23.

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2. (Cont'd.)

its railroad and properties, and all claims for loss, damage or delay to freight and baggage and all claims for overcharges and for reparation, and all accounts for services, materials and supplies rendered or furnished to the Debtor, whether chargeable in the first instance to expenses, or otherwise.

3. The "interline carriers" involved in this appeal are the 39 railroad systems set forth in the caption of this opinion. All appellants except the Indiana Harbor Belt Railway Company and the Louisville and Nashville Railroad Company intervened in the proceeding below as the Committee of Interline Railroads. The Committee includes 40 additional railroads not here involved.

At the conclusion of the hearing, the court invited the parties to submit an order making mandatory the payment of charges stated "from and after" July 1, 1970. Order No. 9, drafted by the parties, was entered the same day. It ordered the payment of all interline accounts first stated or presented on or after July 1, 1970.[4] It also specifies that it does not prejudice the right of the Interlines to claim priority for interline accounts stated prior to July 1.

A controversy subsequently arose when the Interlines attempted to set off the interline balances they owed Penn Central against amounts owed them by Penn Central. Consequently, on June 24, 1971, the trustees petitioned the court to order that the Interlines pay all balances due. The trustees alleged that the Interlines had failed to honor drafts drawn by Penn Central in total amount of $413 million representing pre-bankruptcy interline balances such as claims for May 1970 freight services.[5] They contended that this violated Order No. 1, paragraph 10, providing:

> All persons, firms and corporations . . . holding for the account of the Debtor deposit balances or credits be and each of them hereby are restrained and enjoined from selling, converting or otherwise dispos-

4. The relevant portion of Order No. 9 states:

> And Now, to wit: this First day of July, 1970, it is HEREBY ORDERED that paragraph 3 of the Order of June 21, 1970, is hereby AMENDED so as to direct and require the Debtor (in lieu of authorizing the Debtor in its discretion) to pay to other railroads freight charges and divisions, passenger or ticket charges and divisions, per diem, mileage, and per diem claims, car repairs, trailer rentals *and all other interline accounts and balances first stated or presented and due to be stated or presented for settlement on or after the date of this Order* in accordance with the now existing rules and procedures of the Association of American Railroads and otherwise in accordance with the rail carriers' ordinary business practice. [Emphasis supplied.]

5. The parties have indicated that these amounts are primarily May 1970 freight and passenger balances.

ing of such collateral, deposit balances or other credits or any part thereof, or from offsetting the same, or any thereof, against any obligation of the debtor, until further order of this court.

The Interlines defended and counterclaimed, alleging that they were entitled to offset amounts they owed Penn Central against amounts Penn Central owed them. They also alleged that Penn Central held in trust for them (a) amounts collected in their behalf for interline freight and passenger services and (b) amounts they paid on Penn Central's behalf for overcharge and loss and damage claims. In addition, they argued that Penn Central's assets should be impressed with an equitable lien for such amounts. In counterclaiming, they further alleged that Order No. 9 required Penn Central to pay immediately unpaid interline balances which would become subject to draft in July and represented pre-June 20 car repairs, passenger receipts, and services and supplies.

The district court ruled in favor of the trustees and entered Order No. 613 enjoining any further setoffs. The Interlines appeal that order. They argue (1) that Penn Central holds in trust balances arising from freight and passenger services rendered by the Interlines; (2) that other interline accounts must be paid because the Interlines are compelled by law to perform these services; and (3) that Order No. 9 requires the payment of May 1970 car repair charges and passenger balances which become subject to draft in July.

II. Freight and Passenger Accounts

Freight and passenger charges are collected by the originating or destination carrier for services performed by the Interlines. Under the AAR rules, instead of separately paying each carrier that participates in an interline

shipment, the shipper pays all freight charges to either the originating carrier when the shipment is "prepaid" or to the destination carrier on "collect" shipments. Funds collected are deposited in the collecting carriers' general accounts. The interline railroads make numerous collections for each other daily which are segregated and settled monthly. No interest is paid by the collecting carrier for the period it holds another carrier's revenue.

The destination railroad is responsible for preparing and settling interline freight accounts. It prepares an "abstract" on which the appropriate freight charges are allocated to the participating carriers. It then "not later than the eighteenth of the succeeding month" sends copies of the abstract to the other carriers.[6] The carriers may then *immediately* draw a draft on the destination railroad for the *net balance* due for the month. The destination carrier must include in the monthly accounting all charges for which the destination carrier has received a waybill, whether or not the shipper paid. The waybill is issued by the originating carrier and prescribes the movement of the shipment and charges. The charges which Penn Central has not paid in the instant case represent May 1970 freight services; Penn Central declined drafts submitted on or after June 22, 1970, of approximately $15 million for these accounts.

Passenger accounts are handled similarly. The monthly reports, however, are not required until the last day of the first month following the service. Net passenger balances also are subject to immediate draft upon receipt of the statements. Penn Central has declined drafts sub-

6. If the settling carrier is unable to forward the interline freight summary in time to reach the other carriers by the twentieth of the month, upon request, it must notify the carriers by prepaid telegram. Thus, freight balances are subject to draft, at the latest, on the twentieth.

mitted on or after July 1, 1970, for approximately $280,000 for May traffic.

The AAR interline accounting system is in essence, therefore, a system by which one railroad collects monies owed by shippers to both itself and other railroads. The monies collected belong only in part to the collecting railroad; as to monies owed other railroads, the collecting railroad serves merely as a receiving and transmitting agent. A common sense interpretation of this system would indicate that funds collected by one railroad for and in behalf of another railroad are held in trust by the collecting railroad until the monies are transmitted. Whether the money is held in trust must be determined, however, not merely by reliance on common sense, but also by application of traditional legal doctrines. We therefore turn to the law of trusts to make that determination. In applying the law of trusts, it will be necessary to examine the manifestation of intent of the parties, not only in terms of written documents, but also in terms of the conduct of the parties. Especially important in the present case are (1) the absence of any payment of interest on monies collected during the time they are held by the collecting railroad, and (2) the commingling of the monies with general funds by the collecting railroad.

Accommodating and applying traditional common law trust principles to the unique regulatory scheme and accounting policies used by the nation's railroads, we have concluded that transportation and freight charges, *when collected,* are held in trust for the Interlines. They are therefore entitled to have their monies immediately.

A trust is defined in *Restatement (Second) of Trusts* § 2 (1959) as:

> [A] fiduciary relationship with respect to property, subjecting the person by whom the title to the property

is held to equitable duties to deal with the property for the benefit of another person, which arises as a result of a manifestation of an intention to create it.

The parties' manifestation of intention ultimately controls whether or not a trust relationship exists, but failure to expressly designate the relationship as one of trust does not necessarily negate its existence. *See United States v. Orsinger,* 428 F.2d 1105, 1112 (D.C. Cir. 1970); *Del Drago v. Commissioner,* 214 F.2d 478, 480 (2d Cir. 1954); *State v. United States Steel Co.,* 12 N.J. 51, 95 A.2d 740, 744 (1953); 1 *A. Scott, Law of Trusts* § 2.8 (1967). When the language of the parties fails to clearly indicate their intention, it may be ascertained by other objective manifestations of intent, such as the facts and circumstances surrounding the transaction and the relationship of the parties. *Stratford Financial Corp. v. Finex Corp.,* 367 F.2d 569, 571 (2d Cir. 1966); *In re Chicago Express, Inc.,* 222 F. Supp. 572 (S.D.N.Y. 1963); 1 *A. Scott, supra,* § 12.2, at 108.

A significant fact in the instant case warranting careful consideration is the absence of any provision for the payment of interest by the collecting carrier. Although not conclusive, its absence indicates the presence of a trust relationship. *See United States v. Orsinger, supra; State v. Atlantic City Electric Co.,* 128 A.2d 861, 865-66 (1957); *State v. United States Steel Co., supra.* A debtor-creditor relationship entails the right to use another's money, the usual quid pro quo for which is the obligation to pay interest. *See* 1 *A. Scott, supra,* § 12.2, at 108. Conversely, the collection by Penn Central as an agent of money due and owing the other railroads suggests a trust. *See, e.g., In re Chandler Insurance Agency, Inc.,* 92 F. Supp. 878 (D. Md. 1950); *National Indemnity Co. v. American National Bank,* 120 F. Supp. 713 (D. Minn. 1954), *aff'd,* 222

F.2d 513 (8th Cir. 1955); *Restatement (Second) of Trusts* § 12, comment h (1959).

On the other hand, appellee trustees argue forcefully that the Interlines, by permitting Penn Central to commingle monies due them with Penn Central's general revenues, established a debtor-creditor relationship and not a trust. While generally commingling indicates a debtor-creditor relationship and not a trust, it is only one indicium and it too is not necessarily conclusive. *See National Bank v. Insurance Co.*, 104 U.S. 54, 68 (1881); *MacBryde v. Burnett*, 132 F.2d 898, 900 (4th Cir. 1942); *State v. United States Steel Co.*, 12 N.J. 51, 95 A.2d 740, 744 (1953).

Commingling of monies has minimal significance in the extraordinary operations of interline railroads. That Penn Central is not, as a destination carrier, required by the other carriers to immediately segregate funds collected does not necessarily reflect any intention to establish a debtor-creditor relationship in the face of the unique and complex interline railroad system. Normal operation conditions with innumerable daily collections of various categories preclude practically and economically any effective daily segregation. Burlington Northern Railway alone has more than 1300 stations from which waybills are issued.[7] This is not a simple situation of one party receiving money clearly designated as payment for services performed by another. When a carrier collects funds for

7. The affidavit of Assistant Vice President Wigstrom of Burlington Northern, Inc., asserted:

> [A]t more than 1300 stations must transmit to the Company's general offices (through three regional customer accounting centers) the waybill for each shipment terminated at their respective stations. The waybill data for every terminated interline shipment must, as noted by Mr. Bergey, be abstracted in order to prepare the interline settlement statement. The settlement of interline accounts cannot be achieved either practically or economically among the nation's railroads on anything approaching a daily basis.

another railroad, it does not immediately know what portion of the revenues collected is to be allocated to other carriers.

Mr. Hill, Penn Central's Vice-President-Comptroller, testified that Penn Central settles regularly with more than 300 interline carriers. Settlement involves calculating amounts due each carrier for many different waybills sent daily to Penn Central. We recognize the enormous difficulties confronting the destination carrier to correlate each of these waybills with payments received on a monthly basis, not to mention daily basis, and to segregate funds received according to the waybills.

AAR rules merely serve to evidence the necessities of the situation. To accommodate the carriers in this exceedingly voluminous and complicated accounting system, the AAR rules require that the statements be rendered only once each month and give the carriers 18 days to prepare the abstract of the interline freight accounts after the end of the month in which the waybill is received. The rules also indicate the difficulty in segregation of collections. They require that accounts may be drawn on the collecting carrier after the specified period even though in some instances the charges have not yet been collected from the shippers.[8]

Each party in this controversy finds support for its position in a number of cases that specifically concerned interline accounts. Although we think none are directly in point with this case,[9] none rebut our conclusion that the freight and transportation collections are held in trust.

8. The 18-day period, in addition to facilitating accounting, preserves the fairness of the nonsegregation because most of the charges have been collected by the time of the drafting date.

9. The Interlines rely on Morgenthau v. Sugarland Railway Company, 83 F.2d 72, 74 (5th Cir. 1936); Baltimore & Ohio R.R. Co. v. Thompson, 80 F. Supp. 570, 586 (E.D. Mo. 1948), *aff'd*, 180 F.2d 416 (8th Cir. 1950); and Atlantic Coast Line Railroad v. Pennsylvania Railroad Company, 12 F. Supp. 720 (E.D. Pa. 1935), to

In *Southern Railway Company v. United States,* 306 F.2d 119 (5th Cir. 1963), the court refused to accord priority to interline claims of the Southern Railway against the receiver of the Tallulah Falls Railway Company for amounts earned by Southern or paid by Southern to other carriers and collected by the receiver. According to the court, the freight payment first became in arrears in June 1958, and the receiver repeatedly advised Southern that it was unable to make the payments. Nonetheless, Southern made no demand for segregation of monies collected for it until May 1960. The court declined on a "laches" theory to accord the interline claims priority. It reasoned that Southern knew of the precarious financial situation of the railroad in receivership but continued to disburse its own funds to prior connecting carriers "with full awareness that the funds were not being reimbursed by the Receiver and that, as with routine day-to-day operating charges, the Receiver was using its money, its supplies, and its facilities on which to run the Railroad." *Id.* at 125.

The Interlines in this case, however, were not guilty of such folly. They began demanding payment within three days of filing the reorganization petition. *Southern Railway,* moreover, does contain dictum indicating that, aside from the laches problem, the court indicated the funds collected acquired a trust character at the time the accounts were presented.[10] The court stated:

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9. (Cont'd.)

support their contention that the passenger and freight account monies were held in trust. Although there is dicta in each of those cases indicating that such funds collected by an interline carrier are held in trust, we do not rely extensively on that dicta, because the issue of whether or not a trust existed was not squarely presented to the court in any of the cases.

10. The settlement procedure in *Southern* was similar to that in this case. The court described it as follows:

> The two carriers had a junction settlement arrangement under which freight interchanged was re-billed at Cornelia. On traffic

> The Receiver had a right to collect and to *retain*. The duty to remit was limited to the balance when and as struck in the periodic settlements. Only then did funds, rightfully collected and mingled, acquire a "trust" character.

306 F.2d at 125. Applying this statement to the case sub judice, the freight accounts for the month of May 1970 acquired a trust character when stated on June 18, 1970.

In re Chicago Express, Inc., 222 F. Supp. 566 (S.D. N.Y. 1963), *aff'd*, 332 F.2d 276 (2d Cir. 1964), *cert. denied*, 379 U.S. 879 (1964), involved a claim by the Pennsylvania Railroad Company for priority in the bankruptcy of a trucking company. By agreement, Pennsylvania carried trailers of the motor carrier "piggy-back" on flat cars. Pennsylvania's charges for this service depended on several variable factors, including the number of trailers transported during a given month, the weight of the trailers, and the distances traveled. The railroad's charges were not related to the trucker's charges to its customers; the Pennsylvania made no inquiry into customer charges. The trucking company was obligated to pay within 15 days from the date of billing by Penn Central. This 15-day

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10. (Cont'd.)

moving inbound to the Tallulah Falls, Southern paid all prior participating carriers their divisions or proportions of the revenue for traffic handled over their lines. For these advances as well as for its own division or proportions of the inbound freight charges, Southern looked to the Receiver for reimbursement and payment. As to such inbound shipments, the Receiver would, and did, collect the freights from consignees. On movements out-bound from the Tallulah Falls, the destination carrier collected the freight charges and paid over to Southern the share due it as well as the Tallulah Falls. The settlement arrangement called for adjustment four times a month. On striking the balance, payment was to be made by, or to, the Receiver or Southern as the case might be.

306 F.2d at 123.

period was referred to by the parties in their rate agreement as a "credit accommodation" and was subject to suspension if payment was not timely. In rejecting the Pennsylvania's argument that proceeds received by the trucker from its shippers to the extent attributable to "piggy back" hauls constituted trust funds held for Pennsylvania, the court explained,

> The following are some of the facts which lead me to conclude, as did the Referee, that the relationship between the parties here was one of creditor and debtor, and not trustee and beneficiary: the absence of an agreement between the Pennsylvania and the Debtor to apportion total charges; the lack of relationship between the amount due the Pennsylvania from the Debtor and the overall charge made by the Debtor to its customer; the unconditional duty of the Debtor to pay freight charges to the Pennsylvania within fifteen days from the day of billing, and the "credit accommodation" clause in the "divisional sheet."

222 F. Supp. at 572

These facts in *Chicago Express* clearly differentiate it from the case sub judice. Penn Central did have an arrangement with the Interlines to apportion total charges; the amounts received by the Interlines were directly related to and dependent upon charges paid by shippers; and the amounts owed to the Interlines were payable immediately upon striking the monthly settlement.

Penn Central argues, however, and the district court agreed, that this issue was previously settled in *In Re Central Railroad of New Jersey*, 273 F. Supp. 282 (D.N.J. 1967), *aff'd per curiam*, 392 F.2d 589 (3d Cir. 1968). It is true that in that case the district court held that the New York Central Railroad Company (NYC) could not set off

amounts it owed the Central Railroad of New Jersey (Central) for post-reorganization freight transportation against amounts owed by Central to it for pre-reorganization freight transportation by NYC. In reaching that result, the court concluded that the amounts collected by Central for NYC's interline service were not trust funds. 273 F. Supp. at 288. We affirmed by a per curiam opinion. To the extent the *Central Railroad* decision is inconsistent with the case sub judice, it should not be followed.

The concurring opinion expresses concern because of our reliance upon established principles of trust law which may in some future case, when possibly "the traditional indicators of a trust relationship" are absent, require a contrary holding and thus might disrupt interline railroad transportation. The principal problem before us is one of accounting for funds belonging to another, readily resolvable by recognized trust and pragmatic considerations to which we have alluded. These principles are appropriate to any industry, regardless of their operational problems, and our decision supports the congressional policy encouraging interline rail transportation of freight and passengers nationwide. We perceive no need to announce an entirely new and necessarily result-oriented rule of law which is not pertinent to our present decision, merely because of the fear that the traditional approach may be restrictive in some future unstated hypothetical situation.

III. Other Interline Accounts

The AAR accounting system and contractual obligations for the interline accounts other than those for freight and passenger carriage present different problems. In order to ascertain whether setoffs should be allowed as to Penn Central liabilities on these accounts, it is necessary to examine them seriatim.

Car Repairs. The Interlines frequently repair the equipment of other connecting carriers under the requirements of the National Safety Appliance Act, 45 U.S.C. § 13. AAR rules direct the rendition of bills for repair work no later than the last day of the following month. A draft for payment may be drawn on or after the fifteenth of the second following month.

Overcharge and Loss and Damage Accounts. When a shipper finds too much has been charged by the railroads, or that he is due payments for loss of, or damage to, the goods shipped, he makes a claim to any carrier which participated in the shipment. That carrier investigates the shipper's claim, makes whatever payment is necessary, and then charges the responsible carrier. Accounts are stated on the 10th of each month for all shipper overcharge claims finally settled and all shipper loss and damage claims actually paid. The carrier which has paid the claim may then draw a draft on the responsible carrier on or after the 25th day of the same month.

Per Diem Accounts. When one railroad uses the cars of another railroad, it pays that carrier a daily rental. Reports of amounts owed are forwarded to the owing carrier by the 10th day of the second month following use of the car. The net balances of these accounts are subject to immediate draft.

Switching Accounts. When one railroad switches a car for the benefit of another railroad, a switching charge is made. Such charges for cars moving in interline shipments are computed by the destination carriers and then sent to the Interlines no later than the 18th day of the month after the charges were incurred. Settlement is on the 25th day of that month.

We have concluded that amounts due on these accounts are not held in trust. These accounts do not involve col-

lection of money by one carrier for another. These accounts merely represent the performance of services by one railroad. Although no interest was paid to Penn Central, no accounts except for the per diem balances were subject to immediate draft as were the freight and passenger accounts. Therefore, as to these accounts, the Interlines at this juncture are in exactly the same position as other suppliers of Penn Central who were unpaid for goods and services delivered prior to the filing of the reorganization petition.

The Interlines argue that these amounts must be paid immediately because the accounts "arise directly from specific statutory requirements and are absolutely essential to the operation of a national rail transportation system." They argue that they are compelled (apparently by 49 U.S.C. §1(4)) to permit use of their box cars by Penn Central and other carriers. Similarly, the National Safety Appliance Act, 45 U.S.C. §13, requires that they repair Penn Central's cars if they break down on their tracks. They argue that a destination carrier is required by law to process claims for damage to goods in transit and to advance monies to discharge or settle the claim.

Despite the legal obligation to perform the services, there is no compulsion, statutory or otherwise, as to the manner by which the services shall be paid. Arrangements for payment or credit are voluntary.[11] Most im-

11. The district court properly reasoned:

> While it is true that the interline railroads are required, for example, to accept from each other and to transport freight and passenger traffic and to correct unsafe conditions found on each other's cars, there is no requirement that interline railroads extend credit to each other. In fact, in proceedings leading to the entry of Order No. 9, the interline railroads detailed measures that could be taken to put a railroad, that could not be counted on to make its interline balance settlements, on a 'cash' basis. *E.g.*, Tr. 23-26; Memorandum of Burlington Northern, Inc. (Document No. 18) at 5. Moreover, it is apparent that the

portant, however, is the recognition that no money is collected as to these accounts by Penn Central for other railroads.

The overcharge, loss, and damage accounts present a more difficult problem conceptually. Nevertheless, the essential basis for a trust does not exist. AAR practices call for one carrier to advance sums on behalf of other carriers when valid claims are made by shippers. Such advances are, in effect, a service one carrier renders for other carriers, similar to the services the Interlines perform for each other in renting and repairing cars. In a sense, if the Penn Central receives payment for a shipment, part of which eventually has to be repaid to the shipper, it could be argued that Penn Central in the interim holds the sums in trust to return to the paying carrier. However, at the time Penn Central originally received the freight payments, it had no notice that at a later date part of those sums would have to be returned. Any overcharge, loss, or damage claims at that time would be inchoate and amorphous. The relationship between the advancing carrier and the liable carrier is thus much closer to that of debtor-creditor than that of trustee-beneficiary.

Previously, we upheld the reorganization court's authority to prevent banks from using the self-help remedy of setting off amounts owed them by Penn Central against their obligations to Penn Central. *In re Penn Central Transportation Company*, 453 F.2d 520 (3d Cir. 1971) (the *Bank Cases*). Similarly, we have upheld its authority to enjoin shippers from setting off amounts Penn Central

11. (Cont'd.)

interline railroads' description of such measures did not exhaust the list of measures that could be used to put a railroad on a cash payment rather than a credit basis. *See* Southern Ry. Co. v. Flournoy, 301 F.2d 847, 855-56 (4th Cir. 1962) (security deposit; creditor railroads' control of car movements).

owed them for freight loss and damage claims against amounts they owed Penn Central for freight services. *In re Penn Central Transportation Company,* Nos. 72-1436 to 1438 (3d Cir. 1973) (the *Shipper Cases*).

In the *Shipper Cases,* we explained: (1) Under the Interstate Commerce Act, 49 U.S.C. §§3(1) and 6(7), freight charges are accorded a preferred status and are not subject to the defense that the carrier owes the shipper money for other items. We noted that the only defense that can be raised to a carrier's suit for freight charges is "that the services have been paid for, that the services were not rendered, that the services were charged under an inapplicable tariff schedule, or that the rates were unreasonable." F.2d at . (2) Although a shipper nevertheless retains a right to assert a counterclaim in a carrier's suit for freight charges, *Chicago & Northwestern Railway v. Lindell,* 281 U.S. 14 (1930), that right is extinguished by the intervention of a railroad reorganization proceeding. (3) Since the shippers' claims did not have the legal status of defenses, they cannot defeat "the right of the railroad to collect absolutely all legal charges for freight services outstanding and unpaid."

In the *Bank Cases,* we reasoned that permitting creditors to refuse to pay their obligations because Penn Central owed them similar amounts would place them in a preferred position over other creditors and endanger the success of the reorganization. We noted: "Even secured creditors of a railroad must submit to the risk inherent in judicial suspension of the rights they normally would have to enforce their liens against property of the debtor during the pendency of a reorganization proceeding. New Haven Inclusion Cases, 1970, 399 U.S. 392 [1970]." 453 F.2d at 523.

In this case, we reaffirm the reorganization court's authority to preclude setoffs. The threat to the reorgan-

ization that we noted in the *Bank Cases* is present in the assertion of these setoffs. Penn Central's choses in action for the various interline charges are entitled to the same status as the freight charges in the *Shipper Cases* and the deposits in the *Bank Cases*. The district court concluded that to permit setoffs could discriminate against many other suppliers of services and equipment and would be unfair because of the unresolved issue of the relative priorities of the claims. It also concluded that Penn Central's cash position would be unduly injured by allowing the setoffs.

In the absence of a trust relationship, whether to permit a setoff is in the discretion of the district court. *See Susquehanna Chemical Corp. v. Producers Bank & Trust Co.*, 174 F.2d 783, 786-87 (3d Cir. 1949). We find no abuse of discretion in the circumstances of this case.

For the foregoing reasons, the interline railroads may not set off their claims, except for freight and passenger accounts, against amounts owed by them to Penn Central. The freight and passenger claims are entitled to different treatment because of their trust character and the Interlines' resulting right to immediate payment regardless of the reorganization.

IV. The Effect of Order No. 9

Order No. 9 requires Penn Central to pay all interline accounts "first stated or presented for settlement on or after [July 1, 1970]." Appellants argue that Penn Central's failure to pay for May 1970 car repairs, which became payable on or after July 1, violates the order.[12]

12. Appellants also make this argument as to passenger accounts, but since we have concluded that the passenger receipts are held in trust, we need not specifically discuss their status under Order No. 9. In the district court, appellants also asserted that unpaid miscellaneous bills were required to be paid by Order No. 9, but they do not press this contention on appeal.

The district court rejecting appellants' argument reasoned:

> This interpretation equates presentation of a draft and statement of the account; more importantly, it overlooks the word "first" in the Order. Accounts which were either stated or presented prior to the date of Order No. 9 were not required by that Order to be paid, and thus respondent's contentions with respect to the Car Repair and Passenger accounts are clearly without merit.

We agree with the district court.

Appellants argue that the parties drafted the language of the order and that the testimony at the hearing prior to its issuance demonstrates that they intended it to require payment of all sums that became payable in July 1970, not just those stated for the first time in July. They note that Penn Central's Comptroller, Charles Hill, in explaining Penn Central's intention to pay "interline accounts to be presented after or scheduled to be presented after June 30," presented to the court an exhibit showing the amounts Penn Central planned to pay in July. Specifically included were drafts in the amount of $1 million for car repairs, which became subject to draft on July 15 under the AAR rules. Moreover, they note, Mr. Hill stated:

> The initial indication of actual disbursements begins with July 23 on revenue accounts, on July 13 on mileage accounts, and intermediate dates on car repairs.

The accounts that became subject to draft on July 15 would, under the AAR rules, represent May car repairs. Appellants also note that their counsel stated to the district court that if the order they propsed to the court in their motion of June 24, 1970, i.e., that Penn Central be required

to pay *all* interline balances, were not granted that they would be satisfied with an order which "embraces those accounts and balances which Penn Central contemplates paying in July."

From this course of events, we conclude that the Interlines undoubtedly favored payment of interline accounts in full and that they proposed as a less drastic remedy that Penn Central be bound by its projections for July. Unfortunately, the step we cannot take is to conclude that the district court accepted either of these positions. The district court, in inviting counsel to submit an order to it, stated that it was adopting the projections:

> The order which is being entered is not to be taken as either approval or disapproval of the projections set forth in these documents or of any of the projected expenditures.

The district court explained that it desired an order separating pre-petition interline charges from post-petition interline charges. It concluded that "charges stated from and after today would represent the post-petition interline balances" and specifically asked counsel to prepare an order providing for their payment.[13]

We think the court's oral statement pertaining to its order indicates that Order No. 9 did not contemplate the

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13. The court stated:

> From the evidence presented, it seems quite apparent that the post-petition interline charges, that is to say the charges stated from and after today would represent the post-petition inter-line balances, can be paid without unduly jeopardizing any of the other essential payments that the railroad must make.
>
> I therefore will enter an order and will invite counsel to submit the written order for entry which will make mandatory the payment of post-petition inter-line balances until further order of this Court.

payment of all accounts that would become due for payment in July. The phrase "charges stated" is most reasonably interpreted as meaning charges first reported in the month of July. It strains the language unduly to interpret it to mean charges which have been previously reported but for which payment becomes due in July. The stark language in the actual order, i.e., "stated or presented," could arguably be interpreted to encompass charges for which the drafts are presented in July, but we think the district court's statement to the parties as to the nature of the order he desired to enter precludes this interpretation.

We also believe that the district court's interpretation of its own order in the decision appealed from is entitled to great weight. We find no compelling basis to hold otherwise. We have already found that the parties' objections to the district court's entry of this order are without merit. They can petition the district court again if they believe that it should exercise its discretion to modify the order. We also note that the court in entering Order No. 9 provided explicitly that it would not prejudice the rights of the Interlines to claim a priority at a later time.

The order of the district court will be affirmed except as it operates to preclude the interline carriers from offsetting amounts they owe Penn Central against amounts Penn Central owes them for freight and passenger services. The Interlines shall be entitled to offset any amounts Penn Central owes them for freight and passenger services as of the date of this opinion, and Penn Central will be required to pay them immediately any remaining balances due for these accounts. The case will be remanded to the district court for the entry of an order consistent with this opinion.

ADAMS, *Circuit Judge,* concurring:

Though I concur in the result reached in this case, I am troubled by the heavy reliance by the majority upon the time-worn tenets of trust law in dealing with the issues presented here. Inasmuch as this appeal involves the functioning of the national transportation network, closer attention to pragmatic factors and to Congressional pronouncements would appear to be warranted.

Congress has long been concerned with the establishment and maintenance of a viable national rail system. In part, this concern is manifested in legislation tailored to encourage and facilitate "interline" rail transportation of freight and passengers.[1] To resort, as the majority does, primarily to "traditional common law trust principles" to resolve this case is to overlook the legislative policy embedded in these pertinent statutes. Moreover, the majority's stance fails to address the practical problems confronting the railroad industry today. In this time of proliferating difficulty for the railroads, such an approach does little to advance the enterprise of "developing, coordinating and preserving a national transportation system."[2]

Section 1(4) of the Interstate Commerce Act[3] makes it the duty of each regulated rail carrier to participate in the interstate transportation of freight and passengers. In addition, it requires that the carriers "establish reasonable through routes with other such carriers, and just and reasonable rates, fare [and] charges . . . applicable

1. *See, e.g.,* sections 1(4), 15(3), 15(4) and 15(6) of the Interstate Commerce Act, 49 U.S.C. §§ 1(4), 15(3), 15(4) and 15(6).

2. The National Transportation Policy, 54 Stat. 899, 49 U.S.C. preceding § 1.

3. 49 U.S.C. § 1(4).

thereto."[4] Carriers participating in through routes are directed to "provide reasonable facilities for operating such routes and . . . to make reasonable rules and regulations with respect to their operation . . . ." If connecting carriers fail to create voluntary through routes, section 15(3) of the Act[5] empowers the Interstate Commerce Commission, under certain conditions, to order their establishment.[6]

The policy underlying this statutory arrangement is not difficult to discern. "Interline," long-distance rail carriage over a through route obviates much of the need for duplicative, parallel rail lines. Additionally, through-route service precludes the inconvenience that would result if a shipper had to make separate arrangements with each interconnecting carrier for a long-distance haul. A vigorous and efficient interline rail network thus assures that, as the court below stated "[t]he nation's railroads function in many ways as a single system." The sections of the Interstate Commerce Act discussed above seek to foster and preserve this unitary rail scheme.

There is no statutory compulsion for interconnecting rail carriers to utilize any particular method of collecting fares and freight charges for a through-routed shipment. But, as a practical matter, only one such method is feasible. That is for a single carrier—either the originating or the destination carrier—to collect the entire fare, and then

4. A "through route" is an arrangement between interconnecting railroads for the continuous carriage of goods or passengers from the originating point on the line of one carrier to a destination on the line of another. *See* St. Louis Southwestern Ry. Co. v. United States, 245 U.S. 136, 139 (1917).

5. 49 U.S.C. § 15(3).

6. *See generally* Thompson v. United States, 343 U.S. 549 (1952). Section 15(4) of the Act, 49 U.S.C. § 15(4), limits the power of the Commission to order a through route where to do so would force a railroad to "short haul" itself.

remit to the interline carriers their pro rata portions. This arrangement is apparently subscribed to by the entire industry, and is incorporated in the rules of the Association of American Railroads. A departure from this procedure —for example, insistence by each interline carrier upon immediate payment by the shipper—would likely undermine the entire system of interline rail transportation. At a minimum, it would greatly impede the smooth and efficient functioning of the through-route network.

At least one other court has concluded that, since practical considerations militate so strongly in favor of collection by a single carrier, that carrier should be deemed a "trustee" for the interline railroads.[7] Such a conclusion, when transposed to the scenario of a railroad reorganization case, requires that the interline carriers be granted a superior status vis-a-vis the trustee-railroad's other creditors. Conveniently, there are present in this case enough of the common indicia of a fiduciary relationship to support the majority's conclusion that here, too, the Penn Central holds the interlines' freight and passenger revenues in "trust." Consequently, and I believe correctly, the majority grants the interlines the preferred position that "beneficiary" status merits under the relevant reorganization principles.

What the majority does not appear to consider, and what I suggest may be of critical importance, is the pos-

7. Atlantic Coast Line R. Co. v. Pennsylvania R. Co., 12 F. Supp. 720, 722-23 (E.D. Pa. 1935). In a related case, the same court described a typical interline shipment:

> "[t]he service performed was a haul of citrous fruits from Florida to delivery points in the Northern States. A number of railroads, which we shall call five, participated in order in the carriage, making of it in one continuous haul . . . . The last link at the delivery end was the Pennsylvania Railroad. Because of a convenience so great as to be imperative, the Pennsylvania Company collected for the whole haul." Atlantic Coast Line R. Co. v. Pennsylvania R. Co., 12 F. Supp. 726 (E.D. Pa. 1935).

sibility that, in another case, the *absence* of any of the traditional indicators of a trust relationship would, under their view, require a contrary holding.[8] Exclusive reliance upon the precepts and terminology of trust law would seem, in such a case, to dictate that a court deny the interlines any priority over other creditors. Stripped of that priority, the interlines might well insist upon immediate payment from shippers for each segment of a long-distance haul. Such insistence, with the attendant dislocation of the through-route system, would be especially likely where, as here, the originating or destination carrier was on the verge of going into reorganization.

The disruption of interline transportation that might result from application of the majority's *ratio decidendi* to another case would seriously thwart the policy expressed in the Interstate Commerce Act. Moreover, it would tend to impede promotion of an "adequate, economical, and efficient" transportation system, thus hampering effectuation of our National Transportation Policy.[9] The majority does not address these considerations. Its approach, while leading to a salutary result in the case *sub judice,* overlooks these broader ramifications by focusing too narrowly upon the situation at hand.

Rather than merely invoke the hoary principles of trust law to settle this case, I would treat the problem of interline freight and passenger accounts as a *sui generis* matter. Having perceived Congress' interest in creating and maintaining a viable interline rail system, it would be appropriate to hold that, even in the *absence* of anything formally resembling a "trust," the interlines are entitled to a preferred position with respect to freight and passenger revenues owed them by a railroad in reorganization.

8. Considering the turbulent, changing situation in the railroad industry, this does not seem a remote possibility.

9. *See* Note 2, *supra,* and accompanying text.

This is not to suggest that venerated legal doctrines can never provide guidance to a court confronted with novel questions of transportation law. But where Congress has, by statute and articulation of a national policy, prompted the judiciary to consider the effects of its decisions upon the nation's entire transportation system, there does not seem to be justification for exclusive reliance upon the narrow principles of private law.[10] The demands in treating a matter of national transportation policy are best met by a candid and informed weighing of competing interests, within the compass of the judicial process, rather than by use of dogmas or labels that may prove too inflexible to solve the non-Euclidean problems that are presented.

The majority also concludes that, unlike freight and passenger revenues, other interline monies—those relating to car repairs, overcharges, freight loss and damage, per diem car rentals, and switching charges—are *not* held in "trust." Since this holding would not appear to work any substantial disruption of the interline rail schema, I concur in this aspect of the result as well.

Judge Weis joins in this concurring opinion.

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10. *Cf.* New Haven Inclusion Cases, 399 U.S. 392, 431 (1970).

IN THE

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Nos. 72-1436, 72-1437, 72-1438

IN THE MATTER OF:
PENN CENTRAL TRANSPORTATION COMPANY,

Debtor

INDIANA HARBOR BELT RAILROAD COMPANY,

Appellant in No. 72-1436

MEMBERS OF THE COMMITTEE OF INTERLINE RAILROADS: THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY, ET AL.,

Appellants in No. 72-1437

LOUISVILLE AND NASHVILLE RAILROAD COMPANY,

Appellant in No. 72-1438

Present: VAN DUSEN, ALDISERT, ADAMS, GIBBONS, ROSENN and WEIS, *Circuit Judges.*

ORDER

It is ORDERED that the slip opinion filed October 9, 1973, be amended as follows:

The word "immediately" in the last line of page 9 is deleted;

The word "immediate" in line 6, paragraph 2, page 20, is deleted;

The last two sentences in the final paragraph on page 23 are revised to read as follows:

> The Interlines shall be entitled to offset any amounts Penn Central owes them for freight and passenger services as of the date of this opinion, and Penn Central will be obligated to pay any remaining balances due for these accounts. The case will be remanded to the district court for further proceedings consistent with this opinion.

By THE COURT,

MAX ROSENN,
Circuit Judge

Dated: November 6, 1973

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Nos. 72-1436, 72-1437, 72-1438.

In the Matter of:

PENN CENTRAL TRANSPORTATION COMPANY,
Debtor,

Indiana Harbor Belt Railroad Company,
Appellant in No. 72-1436,

Members of the Committee of Interline Railroads:
The Atchison, Topeka and Santa Fe Railway Company
Illinois Northern Railway
Burlington Northern, Inc.
Oregon Trunk Railway
Chicago, Milwaukee, St. Paul and Pacific Railroad Company
Chicago & North Western Railway Co.
Chicago, Rock Island & Pacific Railroad Co.
Peoria Terminal Co.
Delaware & Hudson Railway Co.
Greenwich & Johnsonville Railway Co.
Grand Trunk Western Railroad Co.
Kansas City Southern Railroad
Louisiana & Arkansas Railway Co.
Missouri-Kansas-Texas Railroad Co.
Missouri Pacific Railroad Co.
Texas & Pacific Railway Co.
Missouri-Illinois Railroad Co.
Chicago & Eastern Illinois Railroad
Norfolk and Western Railway Co.
New Jersey, Indiana & Illinois Railroad
Norfolk, Franklin & Danville Railway

Seaboard Coast Line Railroad Co.
Columbia, Newberry & Laurens Railroad Co.
Southern Pacific Transportation Company
San Diego & Arizona Eastern Railway
Northwestern Pacific RR
Portland Traction Company
Sunset Railway Co.
Visalia Electric Railroad Co.
St. Louis Southwestern Railway Co.
Southern Railway System
St. Louis-San Francisco Railway Co.
Alabama, Tennessee & Northern Railroad Co.
Quanah, Acme & Pacific Railway Co.
Union Pacific Railroad Co.
The Western Pacific Railroad Co.
Sacramento Northern Railway,

Appellants in No. 72-1437,

Louisville and Nashville Railroad Company,

Appellant in No. 72-1438.

APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE EASTERN DISTRICT OF PENNSYLVANIA

(D. C. No. B-70-347 In Bankruptcy)

Present: VAN DUSEN, ALDISERT, ADAMS, GIBBONS, ROSENN and WEIS, *Circuit Judges.*

AMENDED JUDGMENT ON REARGUMENT.

This cause came on to be heard on the record from the United States District Court for the Eastern District of Pennsylvania and was argued by counsel and later reargued by counsel.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court, filed March 16, 1972, be, and the same is hereby reversed, as it operates to preclude the interline carriers from offsetting amounts they owe Penn Central against amounts Penn Central owes them for freight and passenger services. The Interlines shall be entitled to offset any amounts Penn Central owes them for freight and passenger services as of the date of this judgment, and Penn Central will be required to pay them any remaining balances due for these accounts, all of the above in accordance with the opinion of this Court. In all other respects the said order of the said District Court be, and the same is hereby affirmed, and the cause remanded to the said District Court for further proceedings consistent with this opinion.

ATTEST:

THOMAS F. QUINN,
Clerk.

November 6, 1973.

UNITED STATES COURT OF APPEALS

FOR THE THIRD CIRCUIT

Nos. 72-1436, 72-1437, 72-1438.

In the Matter of:

Penn Central Transportation Company, Debtor,

Indiana Harbor Belt Railroad Company,

Appellant in No. 72-1436,

Members of the Committee of Interline Railroads:
The Atchison, Topeka and Santa Fe Railway Company, et al.,

Appellants in No. 72-1437,

Louisville and Nashville Railroad Company,

Appellant in No. 72-1438.

ORDER SUR PETITIONS FOR REHEARING.

Present: VAN DUSEN, ALDISERT, ADAMS, GIBBONS, ROSENN, WEIS, *Circuit Judges.*

The petitions for rehearing filed by Penn Central Transportation Company, Appellee and Chicago and North Western Transportation Company, Appellant in the above entitled case having been submitted to the judges who participated in the decision of this court and to all the other available circuit judges of the circuit in regular active service, and no judge who concurred in the decision having asked for rehearing, and a majority of the circuit judges of

the circuit in regular active service not having voted for rehearing by the court in banc, the petitions for rehearing are denied.

BY THE COURT,

MAX ROSENN,
Judge.

Dated: November 7, 1973.

SUPREME COURT, U. S.

JAN 9 1974

MICHAEL RODAK, JR., CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-914

GEORGE P. BAKER, RICHARD C. BOND, and JERVIS LANGDON, JR., Trustees of the Property of Penn Central Transportation Company, Debtor,

Petitioners,

v.

INDIANA HARBOR BELT RAILROAD COMPANY, MEMBERS OF THE COMMITTEE OF INTERLINE RAILROADS: THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY, *et al.*, and LOUISVILLE AND NASHVILLE RAILROAD COMPANY,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR RESPONDENTS IN OPPOSITION TO THE PETITION

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In the

Supreme Court of the United States

OCTOBER TERM, 1973

No. 73-914

George P. Baker, Richard C. Bond, and Jervis Langdon, Jr., Trustees of the Property of Penn Central Transportation Company, Debtor,

Petitioners,

v.

Indiana Harbor Belt Railroad Company, Members of the Committee of Interline Railroads: The Atchison, Topeka and Santa Fe Railway Company, *et al.*, and Louisville and Nashville Railroad Company,

Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Third Circuit

BRIEF FOR RESPONDENTS IN OPPOSITION TO THE PETITION

Opinion Below

The unanimous opinion of the United States Court of Appeals for the Third Circuit sitting *en banc* is not yet reported. The opinion and amending order are printed in the appendix (A18, A48).

Questions Presented

1. Is this decision, holding that freight and passenger revenues are trust funds and thus not part of the debtor's estate, in conflict with a decision of the Sixth Circuit which dealt solely with the applicability to railroad reorganizations of a statute giving the United States first priority in claims against the estate of an insolvent?

2. Does this decision, which was based exclusively on common law trust principles and thus did not involve the application or construction of Section 77 of the Bankruptcy Act or any other federal statute or rule, present any important question of federal law which should be settled by this Court?

3. Was the Court below correct in finding, through the application of common law trust principles to the accounting rules and regulations of the nation's railroads, that freight and passenger revenues earned by respondent railroads but collected on their behalf by the Penn Central are held in trust?

Statement of the Case

The appeal from the decision of the District Court was argued before three judges of the Court of Appeals for the Third Circuit on April 26, 1973. On May 9, 1973, prior to a decision, the Court *sua sponte* directed that the appeal be reargued before the Court *en banc*. Applying "traditional common law trust principles to the unique regulatory scheme and accounting policies used by the nation's railroads" (A27),* the Court in a 6-0 decision reversed,

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* The following citation form is used: "A" refers to the Appendix to the Petition. "Jt. App." refers to the Joint Appendix filed in the Court of Appeals. "Pet." refers to the Petition for Certiorari.

in part, the order of the District Court and held that freight and passenger revenues earned by respondent railroads* but collected by the Penn Central Transportation Company ("Penn Central") on their behalf are trust funds. It is this part of the decision which petitioners seek to have reviewed.

The case arises against the following background. The interline railroads are required by law to participate in the interstate transportation of freight and passengers and to establish through routes and joint rates. The existence of the national rail transportation system depends upon and could not exist but for this interconnecting rail service (A43-44; see *Southern Ry. Co.* v. *Flournoy*, 301 F.2d 847, 854 (4th Cir. 1962)).

As a result of this compelled relationship, the railroads have established a uniform and elaborate accounting system to facilitate and regularize the collection and distribution of revenues and the apportionment of interline charges. These procedures are embodied in the Accounting Rules of the Association of American Railroads ("AAR Rules") to which the members of that association, including Penn Central and all of the respondents, have agreed and by which they are governed (Jt. App. 69a, 81a).

Only two of the interline accounts established pursuant to these rules are at issue on Penn Central's petition: those relating to the collection of freight and passenger revenues. The salient feature of these two accounts is that all charges for interline freight and passenger transportation are collected by one carrier, regardless of how many intermediate carriers are involved, and thereafter distributed to each participating carrier in proportion to the amount it earned (A25-26).

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* Respondents are the group of railroads ("interline carriers") listed in the Addendum.

(1) Freight Revenues

Every shipper of freight has the right to designate, in the bill of lading, the route of the shipment and the particular carriers which are to participate therein. The total freight charges are fixed by ICC-regulated tariffs which, by application of the established rate "divisions" between the carriers, determine the revenues to be earned by each carrier participating in the shipment. Instead of making separate payments for the freight charges to each of the participating carriers, the shipper or consignee pays all of the freight charges to one carrier; to the origin carrier where the shipment is "prepaid" or to the destination carrier on a "collect" shipment (A25-26; Jt. App. 71a).

The funds collected are deposited in the collecting carrier's general accounts. Because of the vast number of revenue collections which the various carriers make for each other during each month, separate tabulation and segregation of the amounts due the other roads is impossible on any basis shorter than monthly settlements. On the Burlington Northern railroad, for example, in order that interline settlements may ultimately be prepared, agents at more than 1,300 stations must accumulate and transmit, through regional customer accounting centers and on to the company's general offices, the revenue information for each of the hundreds of thousands of monthly shipments (Jt. App. 82a-83a). The Penn Central alone settles with more than 300 carriers (A30).

Under the AAR Rules, the destination carrier on each shipment effects the distribution of the jointly earned revenues pursuant to a monthly settlement. This is done by first preparing an abstract of all revenue waybills, which accompany each separate shipment, to which the established rate divisions are applied (Jt. App. 71-72a). The destination carrier then prepares a series of "summaries" which state the respective payables and receivables between it and each of the other interline carriers

with which it is settling. The summaries and abstracts must be sent by mail or telegram in time to reach the other carriers by the twentieth of the month following the month in which the interline shipments were made. As between two railroads, each strikes a balance based upon the summaries exchanged and the carrier with the net balance in its favor immediately presents a draft for that amount to the other carrier (Jt. App. 72a-74a).

(2) Passenger Revenues

The passenger accounts likewise arise out of the collection by one carrier of transportation charges earned by another and are handled similarly. The monthly reports for these charges are required to be exchanged by the last day of the first month following the performance of the service. Upon the receipt of such reports, net balances are struck and, as with the freight balances, are immediately subject to settlement by draft (A26; Jt. App. 75a).

On Sunday, June 21, 1970, Penn Central petitioned for reorganization. It then declined to honor all drafts presented to it for the payment of interline balances. On July 1, 1970 the Reorganization Court entered an order (Order No. 9) requiring payment by Penn Central of all interline accounts coming due on or after July 1, 1970. That order left open the question of Penn Central's payment of the approximately $33 million in interline accounts which had already come due during the month of June, including approximately $15 million in freight and passenger balances belonging to these respondents (A22-24, 26; Jt. App. 30a (D-3), 32a-33a).

On June 24, 1971 the Trustees petitioned the Reorganization Court for an order directing respondents to pay over to Penn Central the interline balances in the amount of $3.4 million* which had come due in its favor in June

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* The figure given by the Court in its opinion (A24) is a typographical error resulting from transposition of these figures.

1970 but which had been withheld because of Penn Central's refusal to pay the interline balances which it owed respondents for the June settlements. In their answers and counterclaims to this petition, the interline carriers alleged that the freight and passenger revenues collected on their behalf by Penn Central were trust funds and should be paid over to them.

The District Court held that freight and passenger balances were not trust funds, directed that these and the other accounts be paid over to the Penn Central and enjoined any further setoffs (A1-A15). On appeal the Third Circuit *en banc* reversed, in part, the District Court's decision and found that freight and passenger balances were held in trust for the benefit of the carriers performing the services. It further held that the carriers were entitled to offset any amounts* they owed Penn Central against these freight and passenger balances and that they were entitled to be paid the excess of the remaining trust.

In reaching this decision, the court below did no more than apply "traditional common law trust principles" to the "unique regulatory scheme and accounting policies used by the nation's railroads" (A27). While this parochial question is of obvious interest to the parties, it in no way involves an important question of federal law which requires the intervention of this Court. Although the Penn Central seeks to drum up a "conflict" between the Third and Sixth Circuits regarding the nature of freight and passenger balances, there is no such conflict—the Sixth Circuit has simply not decided that question. Further, the decision of the Third Circuit is consistent with statements made by every other circuit court which has had any occasion to consider the character of such interline balances and is correct on the merits.

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* The carriers total offset is estimated at about $7.5 million, consisting of interline balances ($3.4 million) with the remainder miscellaneous accounts.

REASONS FOR DENYING THE WRIT

POINT I

There is no conflict between the decision below and that of any other Circuit Court.

Petitioners have attempted to create the appearance of a conflict between the Third Circuit's decision and an earlier decision of the Sixth Circuit, *In Re Tennessee Central Ry. Co.*, 316 F. Supp. 1103 (M.D. Tenn. 1970), *rev'd*, 463 F.2d 73 (6th Cir. 1972). The decision by the Sixth Circuit, however, had absolutely nothing to do with the question of whether freight and passenger revenues collected by one interline carrier for another are held in trust. The "conflict" is non-existent.

The *Tennessee Central* case originated with a petition by its trustees for a determination of the priority of the various claims filed against the railroad. The government, a creditor therein, claimed a first priority on the basis of Revised Statute 3466 (31 U.S.C. § 191) which gives the government priority in claims against insolvents. The District Court held this statute inapplicable to a railroad reorganization proceeding, and instead accorded a priority to certain railroads, including Penn Central, and other creditors under the so-called "six-months" rule. In passing, the District Court, while noting that the argument had not been raised, stated in *dictum* that the railroad's freight balances were not trust funds, citing the decision in *In Re Central Railroad of New Jersey*, 273 F. Supp. 282 (D.N.J. 1967), *aff'd per curiam*, 392 F.2d 589 (3d Cir. 1968).*

On appeal to the Sixth Circuit, the trust fund issue was not raised. Rather, the sole question before the Sixth

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* The *Jersey Central* decision, insofar as it related to trust funds, was overruled by the Court here (A34).

Circuit was the applicability of R.S. 3466. Citing this Court's decision in *United States* v. *Key*, 397 U.S. 322 (1970), the Sixth Circuit held that R.S. 3466 applied to railroad reorganizations and accordingly reversed the district court and granted the government the priority which it sought.

After the matter was remanded to the Reorganization Court, the railroads there involved sought to have the distribution of the Tennessee Central's assets delayed pending the resolution of the trust fund issue then on appeal to the Third Circuit in this case. Judge Miller (sitting as District Judge by designation) refused to grant the delay, noting that he was bound by the Court of Appeals decision and that:

> "[T]he trust fund theory was not decided by the Court of Appeals, since that issue was not raised . . ." (Memorandum Opinion, p. 4, entered May 24, 1973.)*

Clearly then no issue regarding the status of freight and passenger balances as trust funds has been determined by the Sixth Circuit and there is no conflict thereon.

Penn Central suggests that there is in any event a conflict in "result" between the Third and Sixth Circuit decisions (Pet. 10). Any claimed difference, however, would stem from the fact that different issues were decided by the different courts. There is no conflict between the two decisions. The Sixth Circuit has determined that Revised Statute 3466 is applicable to a railroad reorganization and that the government has first priority among creditors in

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* Judge Miller thereupon directed distribution in accordance with the Sixth Circuit's opinion. The railroads, including Penn Central, have appealed this decision, asserting that they should not be barred, by "law of the case" or laches, from now urging the trust fund issue.

the distribution of the estate. The Third Circuit has determined that freight balances are trust funds, and hence the interline carriers are not creditors at all, but rather beneficiaries of a trust which is not part of the estate. These decisions are perfectly compatible and this Court could affirm both without any conflict.

In terms, there is no lack of uniformity between the two decision, much less "a real and embarrassing conflict of opinion and authority". *Layne & Bowler Corp.* v. *Western Well Works, Inc.*, 261 U.S. 387, 393 (1923).

POINT II

This case involves no important question of federal law.

The question which petitioners seek to have reviewed is whether the Third Circuit was correct in finding that interline freight and passenger revenues collected by one railroad for services performed by another are trust funds rather than ordinary debts. That this in no way involves any question of federal law can be seen by that Court's own characterization of the nature of its determination:

> "Whether the money is held in trust must be determined . . . by application of traditional legal doctrines. We therefore turn to the law of trusts to make that determination." (A27)

After considering the compelled relationship, the huge volume of transactions, the absence of any provision for the payment of interest and the prompt segregation of the revenues upon the determination of their ownership, the Court found that the parties intended a trust relationship to arise (A27-30). Thus:

> "Accommodating and applying traditional common law trust principles to the unique regulatory scheme

> and accounting policies used by the nation's railroads, we have concluded that transportation and freight charges, *when collected,* are held in trust for the Interlines." (A27) [Emphasis in original.]

This is not a determination of a federal question.

It does not help petitioners to observe that the legal status of railroad freight and passenger balances "has never been resolved by this Court" (Pet. 11, 12). There is no reason why it should be. The fact that a given question has not been resolved by the Supreme Court has never been a recognized basis for the grant of certiorari.

Nor does the possibility that this issue might arise in some other pending railroad reorganization require resolution for the "proper administration" of § 77 of the Bankruptcy Act (Pet. 11). In the first place, there is no conflict between the various reorganization courts on this issue nor is there any real likelihood that one will arise.*

Furthermore, the argument that this issue may arise in other reorganizations could be made with respect to virtually any question arising in the course of a reorganization proceeding. Indeed, the Trustees have successfully opposed review in other matters arising out of this reorganization, notwithstanding that the questions involved were obviously of equal applicability to the other pending railroad reorganizations and involved equally substantial sums of money;

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* Although petitioners note that seven other railroad reorganizations are currently pending (Pet. 6), three are in the Third Circuit and will obviously be governed by the decision below. In two others, the trust fund issue never arose since the interline freight balances owed by the bankrupts were simply paid over (Boston & Maine) or were insignificant (Lehigh & Hudson). As to the remaining two reorganizations (the Erie Lackawanna and the Ann Arbor) there is no reason to believe that the reorganization courts, or the Sixth Circuit, if the issue reaches that Court, will not agree with and follow the unanimous decision of the Third Circuit.

moreover, the question in each such proceeding, unlike the question here, was directly related to the interpretation and construction of the bankruptcy laws. *In Re Penn Central Transportation Co.*, 315 F. Supp. 1281 (E.D. Pa. 1970), *aff'd*, 453 F.2d 520 (3d Cir. 1971), *cert. denied*, 408 U.S. 923 (1972) (the *Banks* setoff case); *In Re Penn Central Transportation Co.*, 339 F. Supp. 603 (E.D. Pa. 1972), *aff'd*, 477 F.2d 841 (3d Cir.), *cert. denied*, 42 U.S.L.W. 3213 (No. 72-1698), *aff'd sub nom. U.S. Steel Corp.* v. *Trustees*, 42 U.S.L.W. 3213 (No. 73-94) (U.S. Oct. 15, 1973) (the *Shippers* setoff case); *In Re Penn Central Transportation Co.*, 325 F. Supp. 294 (E.D. Pa. 1970), *aff'd*, 452 F.2d 1107 (3d Cir. 1971), *cert. denied*, 406 U.S. 944 (1972) (the State and Municipal Tax case); see also *In Re Penn Central Transportation Co*, 354 F. Supp. 717 (E.D. Pa. 1972), *rev'd*, 484 F. 2d 323 (3d Cir.), *cert. denied*, 42 U.S.L.W. 3327 (U.S. Dec. 3, 1973) (the Park Avenue Properties case).

In sum, this case involves nothing more than the interpretation and application of common law trust principles. There is no federal question here, important or unimportant, and the fact that the issue may conceivably arise in some other railroad reorganization does not transform a parochial question into a federal one.

POINT III

The Court of Appeals was correct in holding that interline freight and passenger balances collected by one railroad for services performed by another are held in trust.

Contrary to Petitioners' criticisms (Pet. 15), the Third Circuit's decision is both logical and in accord with common law trust principles and is consistent with the statements of all other circuit courts which have had occasion to consider the nature of these revenues.

The Third Circuit summarized the railroad accounting system in the following language:

> "The AAR interline accounting system is in essence, therefore, a system by which one railroad collects monies owed by shippers to both itself and other railroads. The monies collected belong only in part to the collecting railroad; as to monies owed other railroads, the collecting railroad serves merely as a receiving and transmitting agent." (A27)

The Court pointed out that a "common sense interpretation" of this system would be that funds collected by one railroad on behalf of another "are held in trust . . . until the monies are transmitted" (A27). Petitioners seemingly criticize the Court for this application of "common sense", as though it were somehow out of place in a judicial proceeding (Pet. 12-13). But the reasonableness of the holding that a person who "serves merely as a receiving and transmitting agent" for monies belonging to another is a trustee (A27) is fully reinforced by the application of traditional common law trust doctrines.

It is settled that one who collects revenues for another holds them in trust absent a clear showing of a contrary intent. RESTATEMENT (SECOND) OF TRUSTS § 12(h). Thus it has been said that:

> "[W]hen one of two or more joint creditors accepts payment of the obligation, he holds the proceeds as a trustee or agent for them and is directly accountable to them as such." *Cober* v. *Connolly*, 20 Cal.2d 741, 128 P.2d 519, 521 (1942).

The Third Circuit noted this principle and found no such contrary intent here. Of particular significance to the Court was the absence of any provision for the payment of interest by the collecting carrier. As the Court stated:

> "Although not conclusive, its absence indicates the presence of a trust relationship. See *United States* v.

Orsinger, supra; State v. *Atlantic City Electric Co.*, 128 A.2d 861, 865-66 (1957); *State* v. *United States Steel Co., supra.*" (A28)

Petitioners complain of the Court's finding (A29) that commingling of monies has minimal significance as to the parties' intent in the extraordinary operations of interline railroads. Thus they suggest that if a trust were intended, the AAR Rules would have been amended subsequent to the *Jersey Central* case, *supra*, so as to "require segregation of the funds collected" or "bar the collecting carrier's use of the funds" (Pet. 13). No such amendment was possible, however. As the Third Circuit pointed out, an immediate segregation of freight and passenger revenues is not even remotely feasible:

> "Normal operation conditions with innumerable daily collections of various categories preclude practically and economically any effective daily segregation. Burlington Northern Railway alone has more than 1300 stations from which waybills are issued. This is not a simple situation of one party receiving money clearly designated as payment for services performed by another. When a carrier collects funds for another railroad, it does not immediately know what portion of the revenues collected is to be allocated to other carriers." (A29-30)

It is equally impossible to prohibit the collecting carrier's use of the funds collected until such time as the segregation can be accomplished, since an indeterminate amount also represents earnings belonging to that carrier. It is important to note, however, that as soon as the monthly statements are rendered and ownership of the various revenues is thereby determined—which is the earliest point at which the funds could conceivably be "segregated"—the net balance due to any given carrier is subject to an immediate draft (A26; Jt. App. 73a-74a). This is a clear manifestation of the parties' intention that the revenues be treated as trust funds.

Petitioners suggest that the railroads include in their settlements all freight charges for transportation within the previous month regardless of whether the charges have actually been collected and that, to the extent of this difference, there is no "corpus" on which to impress a trust (Pet. 14-15). The extension of credit beyond 120 hours after delivery is, however, prohibited. Interstate Commerce Act § 3(2), 49 U.S.C. § 3(2); ICC Order No. 73, 49 CFR § 16(e); Jt. App. 84a. Since the monthly statements are not presented until the 20th of the month following delivery, it is obvious that the parties intended that outstanding charges would be paid and the trust corpus in existence by that time.

Petitioners also complain that the Court did not follow Judge Augelli's decision in *In Re Central Railroad of New Jersey,* 273 F. Supp. 282 (D.N.J. 1967), which had been affirmed *per curiam* by a panel of the Third Circuit, 392 F.2d 589 (1968). The only significance of this is that the entire Court, after full consideration of the question, disagreed with Judge Augelli. This was its right and patently furnishes no basis for seeking review by this Court.

Finally, it should be noted that the Third Circuit's holding is consistent with the view of every other circuit court which has had any occasion to consider the status of these revenues. *Southern Ry Co.* v. *United States,* 306 F.2d 119, 125 (5th Cir. 1962); *Thompson* v. *B&O R. Co.,* 80 F. Supp. 570, 586 (E.D. Mo. 1948), *aff'd,* 180 F.2d 416, 420-421 (8th Cir. 1950); *Accord, Atlantic Coast Line R. Co.* v. *Penn R. Co.,* 12 F. Supp. 720, 722-723 (E.D. Pa. 1935). See also *In Re Chicago Express, Inc.,* 222 F.Supp. 566, 572 (S.D.N.Y. 1963), *aff'd,* 332 F.2d 276 (2d Cir.), *cert. denied,* 379 U.S. 879 (1964); *Morgenthau* v. *Sugar Land Ry. Co.,* 83 F.2d 72, 74 (5th Cir. 1936). Representative is *Southern Ry. Co., supra,* where the court stated that:

> "The Receiver had a right to collect and to retain. The duty to remit was limited to the balance when and as struck in the periodic settlements. Only then did funds,

rightfully collected and mingled, acquire a 'trust' character." 306 F.2d at 125.

The opinion below thus represents a reasoned application of common law principles of trust and equity to the complex railroad accounting system and is, we submit, eminently correct.

CONCLUSION

For each of the foregoing reasons the Trustees' Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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ADDENDUM

Respondents

The Atchison, Topeka and Santa Fe Railway Company
    Illinois Northern, Inc.
    Illinois Northern Railway
Burlington Northern, Inc.
    Oregon Trunk Railway
Chicago, Milwaukee, St. Paul and Pacific Railroad Company
Chicago, Rock Island & Pacific Railroad Co.
    Peoria Terminal Co.
Delaware & Hudson Railway Co.
    Greenwich & Johnsonville Railway Co.
Indiana Harbor Belt Railroad Company
Kansas City Southern Railroad
    Louisiana & Arkansas Railway Co.
Louisville and Nashville Railroad Company
Missouri-Kansas-Texas Railroad Co.
Missouri Pacific Railroad Co.
    Texas & Pacific Railway Co.
    Missouri-Illinois Railroad Co.
    Chicago & Eastern Illinois Railroad
Norfolk and Western Railway Co.
    New Jersey, Indiana & Illinois Railroad
    Norfolk, Franklin & Danville Railway
Seaboard Coast Line Railroad Co.
    Columbia, Newberry & Laurens Railroad Co.
Southern Pacific Transportation Company
    San Diego & Arizona Eastern Railway
    Northwestern Pacific RR
    Portland Traction Company
    Sunset Railway Co.
    Visalia Electric Railroad Co.
    St. Louis Southwestern Railway Co.
Southern Railway System
Union Pacific Railroad Co.
The Western Pacific Railroad Co.
    Sacramento Northern Railway

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1973.

No. 73-914

GEORGE P. BAKER, RICHARD C. BOND, AND JERVIS LANGDON, JR., TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR,

Petitioners,

vs.

INDIANA HARBOR BELT RAILROAD COMPANY, MEMBERS OF THE COMMITTEE OF INTERLINE RAILROADS: THE ATCHISON, TOPEKA AND SANTA FE RAILWAY COMPANY, ET AL., AND LOUISVILLE AND NASHVILLE RAILROAD COMPANY,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

MEMORANDUM OF RESPONDENT, CHICAGO AND NORTH WESTERN TRANSPORTATION COMPANY.

RICHARD M. FREEMAN,
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Chicago, Illinois 60606,
Attorneys for Respondent, Chicago and North Western Transportation Company.

Gunthorp-Warren Printing Company, Chicago • 346-1717

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GEORGE P. BAKER, RICHARD C. BOND, AND JERVIS LANGDON, JR., TRUSTEES OF THE PROPERTY OF PENN CENTRAL TRANSPORTATION COMPANY, DEBTOR,

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Respondents.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT.

MEMORANDUM OF RESPONDENT, CHICAGO AND NORTH WESTERN TRANSPORTATION COMPANY.

The Trustees of the property of Penn Central Transportation Company (Penn Central) have filed a Petition for Writ of Certiorari to review the judgment (on reargument) of the United States Court of Appeals for the Third Circuit, sitting *en banc*, entered on October 9, 1973, as amended by its judgment entered on November 6, 1973 (rehearing denied November 7, 1973), to the extent that it reversed in part Order No.

613 of the United States District Court for the Eastern District of Pennsylvania entered on March 16, 1972, in Penn Central's reorganization proceedings under Section 77 of the Bankruptcy Act (11 U. S. C. § 205). In reversing in part Order No. 613, the Court of Appeals held that pre-bankruptcy interline freight and passenger balances due other railroads but collected by Penn Central are held in trust for such railroads.

Respondent, Chicago and North Western Transportation Company (North Western), intends to file on or before February 5, 1974[1] a Petition for Writ of Certiorari to review the judgment of the Court of Appeals for the Third Circuit to the extent that it affirmed in part Order No. 613 of the District Court as it applied to pre-bankruptcy per diem balances. The Court of Appeals affirmed the District Court's order enjoining the railroads from setting off per diem balances owed by Penn Central against amounts owed to Penn Central, and its refusal to order immediate payment of, or to declare an equitable lien or constructive trust for, such balances. The Court of Appeals concluded, as did the District Court, that despite the railroads' legal obligation under the Interstate Commerce Act (49 U. S. C. § 1 *et seq.*) to interchange freight cars, the railroads, including North Western, voluntarily extended credit to Penn Central in the amount of the per diem balances.

Two questions to be presented in North Western's petition will be whether, in a Section 77 reorganization, the pre-bankruptcy per diem balances which are created when railroads interchange freight cars under compulsion of federal law, are claims of involuntary creditors superior to claims of voluntary creditors; and whether a reorganization court must order payment or permit setoff of pre-bankruptcy per diem claims, or

1. North Western filed a Petition for Limited Rehearing En Banc within the period prescribed for such filing under the Rules of the Court of Appeals for the Third Circuit. Rehearing was denied on November 7, 1973.

Respondents, Grand Trunk Western Railroad Company and St. Louis-San Francisco Railway Company, have advised North Western that they wish to join in its Petition for Writ of Certiorari.

declare an equitable lien or constructive trust for such claims, unless the court finds that to grant such relief will substantially increase the likelihood that reorganization will fail.

Among the reasons to be presented for the granting of North Western's petition will be that determination by this Court of the status of pre-bankruptcy per diem balances is necessary to the proper administration of Section 77 of the Bankruptcy Act in conformity with Congressional transportation policy embodied in the Interstate Commerce Act, particularly Section 1(14)(a), and in the last sentence of Section 77(j) of the Bankruptcy Act.

CONCLUSION.

This Memorandum is submitted to advise the Court of the Petition for Writ of Certiorari to be filed by North Western, and to respectfully suggest that the Court may wish to defer final action on the Trustees' petition until after North Western's petition has been filed or the time for its filing has expired.

Respectfully submitted,

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